# EXHIBIT “G”

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| | |
|---|---|
| VALUATION OF: | BLUE DIAMOND SHEET METAL, INC., DIAM-N-BLU MECHANICAL CORP., AND MIRAGE MECHANICAL SYSTEMS, INC. |
| EFFECTIVE DATE: | SEPTEMBER 30, 2019 |
| REPORT DATE: | APRIL 10, 2020 |
| PREPARED FOR: | BNB BANK |
| PREPARED BY: | NEAL PATEL, CBA, CVA |
| REFERENCE: | BB-041020 |

**PLEASE NOTE:**
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## CONCLUSION OF VALUE

In the opinion of the undersigned Appraiser, using accepted methods of valuation, and subject to the assumptions and limiting conditions incorporated herein, the Fair Market Value of the Stock (equity) Interest of **Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc.** as of September 30, 2019 is best expressed as (rounded):

| 100% Controlling Interest |
|---|
| Eleven Million Two Hundred Ninety Thousand Dollars<br>$11,290,000 |

## EXECUTIVE SUMMARY

**Effective Date**: September 30, 2019

**Report Date:** April 10, 2020

**Company:** Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc.

**Company D/B/A:** Blue Diamond Sheet Metal, Diam-N-Blu Mechanical, and Mirage Mechanical Systems

**NAICS Code:** 332322 (Sheet Metal Work Manufacturing)

**Ownership interest valued**: 100% controlling interest in the stock (equity) of Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc., as a going concern on a controlling, non-marketable interest basis.

**Purpose of valuation**: The appraisal is being performed to confirm the value of the subject business to assist the Client in its financial underwriting analysis for financing purposes.

**Standard of value:** Fair market value

**Premise of value:** Going concern

**Significant assumptions and limitations:** See Section 1.12 *Assumptions and Limiting Cond.*

**Valuation methods considered:** Market Approach, Income Approach and Asset Approach

**Type of report:** Summary Report (IBA/NACVA), Restricted Appraisal (USPAP)

**SBA Compliance: Meets SBA's requirement as an "independent business valuation from a qualified source," as per the Standard Operating Procedure (SOP) 50 10 5(K) (p. 204).**

# VALUATION SUMMARY

The Small Business Administration (SBA) Standard Operating Procedure (SOP) 50 10 5(K) (p. 141) states the following: The value of the intangible assets is determined by...the value of the business as identified in the business valuation minus the sum of the working capital assets and the fixed assets being purchased. Therefore, Final Value minus (Assets less Liabilities) equals Intangible Assets.

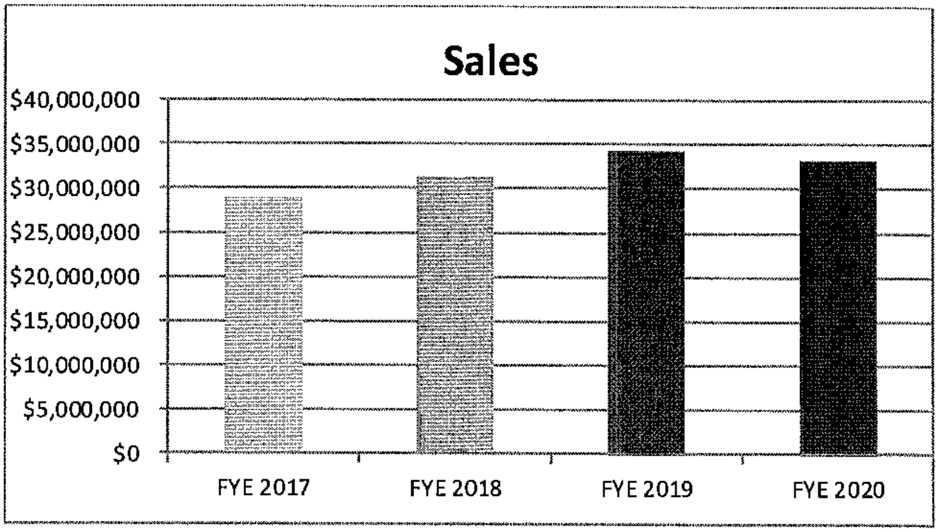
The Final Value below includes only the following assets and liabilities:

| | | |
|---|---|---|
| Final Value | $ | **11,290,000** |
| Cash or Cash Equivalent | | $214,290 |
| Accounts Receivable | | $10,999,968 |
| Inventory | | $167,553 |
| Other Current Assets | | $2,741,944 |
| Fixed Assets | | $1,625,020 |
| Other Assets | | $74,291 |
| Total Tangible Assets Included in Value | | $15,823,066 |
| Current Liabilities | | $5,316,637 |
| Long Term Liabilities | | $209,196 |
| Total Liabilities Included in Value | | $5,525,833 |
| Assets less Liabilities (rounded) | $ | **10,297,000** |
| Final Value minus (Assets less Liabilities) | | |
| Total Intangible Assets Included in Final Value | $ | **993,000** |

The table above is a summary of the final adjusted book value table from Section 5.4 *Application of the Asset Approach*, which provides a detailed description of each asset and liability included in the Final Value.

**Summary of Revenues:** *See Section 4.2 Revenue and Earnings History*

| | 2016 Audited **FYE 2017** | 2017 Audited **FYE 2018** | 2018 Audited **FYE 2019** | Projected - Yr 1 **FYE 2020** |
|---|---|---|---|---|
| Sales | $28,828,055 | $31,192,721 | $34,229,937 | $33,224,648 |
| Change Year Over Year | N/A | 8.2% | 9.7% | -2.9% |




**Summary of Final Value and Valuation Multiples:**

| | | |
|---|---|---|
| Indicated Final Value of Company | $ | 11,290,000 |
| Less: Cash | | (214,290) |
| Less: Accounts Receivable | | (10,999,968) |
| Less: Inventory | | (167,553) |
| Less: Current and Other Assets | | (2,816,235) |
| Add: All Liabilities | | 5,525,833 |
| Indication of Typical Asset Value - Rounded | $ | 2,620,000 |

| **Summary of Revenue & Earnings** | | **Summary of Valuation Multiples:** | |
|---|---|---|---|
| Projected Revenues: | $34,776,559 | Asset Value / Revenue: | 0.08 |
| Projected EBITDA[1]: | $915,265 | Asset Value / EBITDA: | 2.86 |
| Projected SDE[2]: | $1,054,585 | Asset Value / SDE: | 2.48 |

[1]*EBITDA (adjusted) = Earnings Before Interest, Taxes, Depreciation and Amortization*
[2]*SDE (adjusted) = Seller's Discretionary Earnings = EBITDA + Owner's Compensation*

## Summary of Financials and Adjustments: See Section 4.5 *Financial Statement Adjustments*

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Sales | $ 28,828,055 | $ 31,192,721 | $ 34,229,937 | $ 33,224,648 |
| Cost of Sales | 24,637,312 | 26,357,569 | 29,817,374 | 28,707,774 |
| Gross Profit | 4,190,743 | 4,835,152 | 4,412,563 | 4,516,874 |
| Other Income | - | 2 | 8 | 58 |
| Total Expense | 3,368,432 | 3,859,530 | 4,021,865 | 4,015,849 |
| Net Income | 822,311 | 975,624 | 390,706 | 501,083 |
| Pretax Net Income | 822,311 | 975,624 | 390,706 | 501,083 |
| **Operating Adjustments** | | | | |
| Add: Officer's Compensation - Actual | 434,389 | 445,415 | 445,415 | 445,415 |
| Add: Officer's Est. Payroll Taxes | 47,783 | 48,996 | 48,996 | 48,996 |
| Less: Officer's Compensation - Market | (114,393) | (117,824) | (121,359) | (125,000) |
| Less: Officer's Estimated Payroll Taxes | (12,583) | (12,961) | (13,350) | (13,750) |
| Less: Replacement Salary - Rob Belz | (91,514) | (94,260) | (97,087) | (100,000) |
| Less: Replacement Salary (Stephen & James) | (90,599) | (93,317) | (96,117) | (99,000) |
| Less: Estimated Payroll Taxes | (20,032) | (20,633) | (21,252) | (21,890) |
| Add: Rent - Actual | 416,712 | 523,192 | 462,019 | 475,880 |
| Less: Rent - Fair Market | (437,438) | (450,561) | (464,078) | (478,000) |
| Other | - | - | - | - |
| Other | - | - | - | - |
| Other | - | - | - | - |
| Other | - | - | - | - |
| Total Adjustments | 132,325 | 228,047 | 143,187 | 132,650 |
| **Adjusted Pretax Net Income** | $ 954,636 | $ 1,203,671 | $ 533,893 | $ 633,734 |
| + Interest | 142,618 | 148,644 | 155,765 | 136,794 |
| **= EBIT** | 1,097,254 | 1,352,315 | 689,658 | 770,528 |
| % of sales | *3.8%* | *4.3%* | *2.0%* | *2.3%* |
| + Amortization | 4,104 | 2,052 | - | - |
| + Depreciation | 79,718 | 79,862 | 179,023 | 179,023 |
| **= EBITDA** | 1,181,076 | 1,434,229 | 868,681 | 949,551 |
| % of sales | *4.1%* | *4.6%* | *2.5%* | *2.9%* |
| + Market Owner's Compensation (inc. taxes) | 126,976 | 130,785 | 134,709 | 138,750 |
| **= Seller's Discretionary Earnings (SDE)** | $ 1,308,051 | $ 1,565,014 | $ 1,003,390 | $ 1,088,301 |
| % of sales | *4.5%* | *5.0%* | *2.9%* | *3.3%* |

*Each line item above is further discussed in Section 4.5 Financial Statement Adjustments*

## Summary of Weights: See Section 4.9 *Financial Forecast*

**Historical Sales and Estimated Weighting**

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Sales | $ 28,828,055 | $ 31,192,721 | $ 34,229,937 | $ 33,224,648 |
| **Adjusted Pretax Net Income** | 954,636 | 1,203,671 | 533,893 | 633,734 |
| **Earnings Before Interest & Taxes (EBIT)** | 1,097,254 | 1,352,315 | 689,658 | 770,528 |
| **EBIT plus Depr. & Amort. (EBITDA)** | 1,181,076 | 1,434,229 | 868,681 | 949,551 |
| **Seller's Discretionary Earnings (SDE)** | 1,308,051 | 1,565,014 | 1,003,390 | 1,088,301 |
| **Weight** | **0%** | **0%** | **70%** | **30%** |

## Summary of Assets and Liabilities: See Section 5.4 *Application of the Asset Approach*

Adjusted Book Value Method

| *Accrual Basis* | Reviewed 9/30/2019 | Operating Yes/No | Adjusted Book Value | Included in Value | Included in Final Adj. Book Value |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current Assets** | | | | | |
| Cash and Equivalent | $ 214,290 | Yes | $ 214,290 | Yes | $ 214,290 |
| Accounts Receivable | 11,772,608 | Partial | 10,999,968 | Yes | 10,999,968 |
| Inventory | 167,553 | Yes | 167,553 | Yes | 167,553 |
| Costs & Earnings in Excess of Billings | 2,723,897 | Yes | 2,723,897 | Yes | 2,723,897 |
| Prepaid Exp. & Misc. Receivables | 18,047 | Yes | 18,047 | Yes | 18,047 |
| Total Current Assets | 14,896,395 | | 14,123,755 | | 14,123,755 |
| **Fixed Assets*** | | | | | |
| Furniture, Equipment & Fixtures | 400,061 | Appraised | - | | - |
| Vehicles | - | | 286,100 | Yes | 286,100 |
| Machinery and Equipment | - | | 1,338,920 | Yes | 1,338,920 |
| Less: Accum. Depreciation | - | | - | | - |
| Building/Land | - | | - | | - |
| Less: Accum. Depreciation (Building Only) | - | | - | | - |
| Total Fixed Assets | 400,061 | | 1,625,020 | | 1,625,020 |
| **Other Assets**** | | | | | |
| Amortizable Assets | - | | - | | - |
| Less: Accum. Amortization | - | | - | | - |
| Other Assets | - | | - | | - |
| Other Assets | - | | - | | - |
| Deposits | 74,291 | Yes | 74,291 | Yes | 74,291 |
| Total Other Assets | 74,291 | | 74,291 | | 74,291 |
| Total Assets | $ 15,370,747 | | $ 15,823,066 | | $ 15,823,066 |
| **LIABILITIES AND EQUITY** | | | | | |
| **Current Liabilities** | | | | | |
| Trade Accounts Payables | $ 3,051,307 | Yes | $ 3,051,307 | Yes | $ 3,051,307 |
| Line of Credit - Bank | 1,795,000 | Yes | 1,795,000 | Yes | 1,795,000 |
| Current Portion of LTD | 76,711 | Yes | 76,711 | Yes | 76,711 |
| Income Taxes | 281,559 | Yes | 281,559 | Yes | 281,559 |
| Billings In Excess of Costs | 112,060 | Yes | 112,060 | Yes | 112,060 |
| Total Current Liabilities | 5,316,637 | | 5,316,637 | | 5,316,637 |
| **Long Term Liabilities** | | | | | |
| Long Term Loan | 209,196 | Yes | 209,196 | Yes | 209,196 |
| Other Liabilities | - | | - | | - |
| Other Liabilities | - | | - | | - |
| Commercial Real Estate Loan | - | | - | | - |
| Total Long-term Debt | 209,196 | | 209,196 | | 209,196 |
| Total Liabilities | 5,525,833 | | 5,525,833 | | 5,525,833 |
| **Equity** | | | | | |
| Capital Stock / APICapital | 163,000 | | | | - |
| Retained Earnings | 9,681,914 | | | | - |
| Adj. to Equity/Treasury | - | | | | - |
| Total Equity | 9,844,914 | Adjusted | 10,297,233 | Adjusted | 10,297,233 |
| Total Liabilities and Equity | $ 15,370,747 | | $ 15,823,066 | | |

*Each line item above is further discussed in Section 5.4 Application of the Asset Approach.*

# APPRAISER'S CERTIFICATIONS

Reliant Business Valuation, LLC certifies to its best knowledge and belief:

- The statements of fact contained in this report are true and correct to the best of the Appraiser's knowledge and belief.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are the Appraiser's personal, impartial, unbiased opinions, professional analyses, opinions, and conclusions.
- Neither Neal Patel ('Appraiser') nor any employee of Reliant Business Valuation, LLC has any present or prospective interest in the business that is the subject of this report, nor any personal interest with respect to the parties, nor any other interest or bias, which would impair a fair and unbiased valuation.
- Compensation paid to the Appraiser for this valuation is independent of the value reported and is not contingent on the development or reporting of a predetermined value or direction in value that favors the cause of the Client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of the valuation.
- The reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the Code of Professional Ethics and Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Institute (Standards 9-10). The use of this report is subject to the requirements of the Appraisal Institute relating to review by its duly authorized representatives.
- This valuation has been conducted and this report is issued pursuant to the Code of Ethics and Business Appraisal Standards of the Institute of Business Appraisers (IBA), the National Association of Certified Valuators and Analysts' (NACVA) Professional Standards, and the American Society of Appraisers (ASA) Business Valuation Standards, in effect at the date this report was issued.
- The Appraiser <u>has not</u> made a personal inspection of the subject business/property.
- The Appraiser performed no services, as an appraiser or in any other capacity, regarding the Company that is in the subject of this report within the three-year period immediately preceding acceptance of this assignment.
- No one provided significant business valuation assistance to the person(s) signing this certification.

Copies of this report must be signed below by the Appraisers in blue ink in order to be authorized and complete.

Neal Patel, CBA, CVA

Matthew Lore, CVA

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# 1. INTRODUCTION

## 1.1 Subject of the Valuation

The subject of the valuation is Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. three S-Corporations formed in the State of New York. For the purposes of this valuation, the Appraiser will combine the three companies and treat them as one entity (hereafter referred to as "Company"). The Company operates as three entities and provides general engineering, metal fabrication, equipment installation, and industrial maintenance. The Company does business as Blue Diamond Sheet Metal, Diam-N-Blu Mechanical, and Mirage Mechanical Systems. The Company is located at 1165 Station Road, Medford, New York 11763. The Company is best described by the North American Industrial Classification System Code (NAICS) 332322 (Sheet Metal Work Manufacturing). It can also be classified under the Standard Industrial Classification Code (SIC) 3444 (Sheet Metalwork).

The value of a business interest is valid "as of" a specific date, also known as the "Effective Date", which is the date of the most recent financials used in the Appraiser's analysis. The AICPA's Statements on Standards for Valuation Services (in parity with NACVA's Professional Standards) states the following: "*Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date.*" **Therefore, the subsequent event described below has not been considered in the report.** If this report were to have an Effective Date on or after February 29, 2020, this subsequent event described below would have been considered, as most of the indicated information below would be known as of the Effective Date.

As of the Report Date, the Coronavirus Disease 2019 (COVID-19) has caused many parts of the United States, and the world, to take precautions to limit and slow down the spread of the disease. Citizens have been asked to practice social distancing and to not congregate in a group setting. In certain states and/or municipalities, non-essential businesses have been asked to close or alter their business models. These measures put in place to limit and slow down the spread of the disease will cause businesses in various industries (including the subject Company) to either shut their doors for a period of time and/or operate at a lower volume. Additionally, the coronavirus resulted in a pandemic that has adversely affected market conditions. This, along with the prolonged nature of the virus, will likely have a psychological effect on consumer sentiment and their desire to re-engage in activities conducted regularly prior to the disease.

## 1.2 Purpose and Use of Valuation

This valuation was requested by JoAnn Bello and prepared for BNB Bank with a mailing address of 538 Broad Hollow Road, Suite 202, Melville, NY 11747 ('Client'), the only **intended user**.

The purpose of this valuation is to determine the Fair Market Value (defined in Section 1.8) of a 100% controlling interest in the stock (equity) of Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc., as a going concern on a controlling, non-marketable interest basis. The **intended use** (function) of this valuation is to assist the Client in its financial underwriting analysis for financing purposes. This valuation should be used exclusively for that purpose and no other.

**The intended user of this report is only the Client listed above. This report is restricted to the use by Client only in conjunction with the specific purpose and for the use referred to above. Use of this report for any other reason would be invalid due to the preparation of this report under the specific intent it is to be relied upon only for the intended use and by the intended user. In accordance with the executed Engagement Letter between Reliant Business Valnation, LLC and**

**Client in regard to making this report available to and use by a party other than the Client, copies of this report cannot be made or distributed to third parties unless otherwise authorized in writing by Reliant Business Valuation, LLC. Any other party possessing this report (including the Buyer and Seller defined in Section 2.10 Existing Purchase Agreement) is not an intended user, and the Appraiser is not responsible for use of this report by any such third party. This report is not meant for negotiation of the Company's value or loan amount by the Client's borrower or Seller (if applicable).**

## 1.3 Date of Valuation

The Institute of Business Appraisers (IBA) requires that the appraisal report state the effective ("as of") date of the appraisal, and the date the appraisal was prepared.[1] The opinion of value stated in this report could most likely be different if another date had been used as the date of valuation. The effective date of this valuation is September 30, 2019, which is the date of the most recent income statement provided to the Appraiser (also referred to as 'Effective Date'). This report was completed on April 10, 2020 (also referred to as 'Report Date').

## 1.4 Form of Valuation

This analysis and report were completed in accordance with 'The Institute of Business Appraisers' and the 'National Association of Certified Valuators and Analysts'' Professional Standards.

The memberships of the National Association of Certified Valuators and Analysts (NACVA) and the Institute of Business Appraisers (IBA) have voted to ratify the new principles-based standards developed jointly by a team representing both organizations. The "principles-based" standards are in parity with the AICPA's SSVS No. 1, and are effective as of August 1, 2015.

A report expressing a Conclusion of Value may be presented in either a Summary or Detailed Report. A Calculated Value must be presented in a Calculation Report. The SBA SOP 50 10 5(K) specifically requires the following: "The business valuation must include the individual's conclusion of value…" The appraiser notes that a Calculation Report (which arrives at a Calculated Value) does not satisfy the SBA requirement for an independent business valuation from a qualified source. In order to arrive at a Conclusion of Value, the appraisal result is reported here in the form of a Summary Report, as per Standard 5 of the Business Professional Standards of the Institute of Business Appraisers (IBA)[2].

Summary Reports should set forth the Conclusion of Value through an abridged version of the information that would be provided in a Detailed Report as outlined in (C.1.a) through (C.1.i) of the Business Professional Standards as applicable, and therefore, need not contain the same level of detail. In a Summary Report, the Appraiser is still required to perform materially the same investigation and analysis as would be required for a Detailed Report and maintain in his file the work papers necessary to support the conclusions stated in the Summary Report.

As per the American Society of Appraisers Business Valuation Standards (BVS -I, Section II.C), an Appraisal is the act or process of determining the value of a business, business ownership interest, security, or intangible asset. The objective of an appraisal is to express an unambiguous opinion as to the value of a business, business ownership interest, security or intangible asset which opinion is supported by all procedures that the Appraiser deems to be relevant to the valuation.

[1] Institute of Business Appraisers, *Business Professional Standards*, Sec. 5.C(2). Summary Reports.
[2] National Association of Valuators and Analysts. Retrieved from http://www.nacva.com/association/nacva.asp

The report is a Restricted Appraisal Report, as defined in Standard 10-2(b) of the Uniform Standards of Professional Appraisal Practice (USPAP). The Restricted Appraisal Report is for Client use only, and the Client must understand that this type of report must only be used for the purposes stated in Section 1.2 *Purpose and Use of Appraisal*. This prominent use limits the use of the report to the Client and the opinion and conclusions set forth in this report may not be understood properly without additional information in the Appraiser's work file. This form of report is appropriate where, as in this case, the intended readers of the report are already familiar with the pertinent features of the company, its markets, financial performance and the industry environment in which the subject company operates.

## 1.5 Scope of the Assignment

The Appraiser was engaged by the Client subject to time and budget limitations. While the Appraiser's research and analysis were both adequate and reasonable for the scope of the project, they were not unlimited in scope.

Forensic Accounting Excluded

The scope of the valuation assignment is limited to the development of a good-faith estimate or opinion of value based on the standard of value (Section 1.8) and assumptions and limiting condition (Section 1.12) set forth herein. The scope of the report will not include forensic or any other type of accounting.

Reliance of Management Representation

We have relied on representations provided by third parties without independent investigation or corroboration as though they fairly and accurately represent the financial states and activities of the company. Neither our engagement nor this report can be relied upon to disclose any misrepresentation, fraud, and deviations from Generally Accepted Accounting Principles (GAAP) or other errors or irregularities.

Other Assumptions

The Appraiser has no knowledge of issues related to litigation, regulatory compliance, environmental hazards, or other agreements among the owners or third parties, which would have a negative material impact on the value or transferability of the interest being valued. The Appraiser has assumed that all necessary licenses, leases, and other intangibles that are necessary to generate the projected income used in the valuation will transfer to a hypothetical or proposed buyer.

## 1.6 Ownership and Control

As of the date of this valuation, the ownership and control of the Company is (*according to the Bank's Customer Questionnaire*):

**Ownership and Control as of 09/30/2019**

| Shareholder | Percentage Ownership |
|---|---|
| Rob Belz | 25.0% |
| Stephen Dimeglio | 25.0% |
| James Dvorak | 25.0% |
| Al LaBella | 25.0% |
| Total Issued and Outstanding Shares | 100.0% |

## 1.7 Principal Sources of Information

Principal sources of information used by the Appraiser include one or more of the following:

- Financial Statements, income tax returns and/or other financial information prepared by Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc.'s independent accountants or in house management. These include:
    - **The Company's Fiscal Year End is March 31st. In this valuation, the acronym "FYE" will be appended to the year in question, which will represent the year in which the fiscal year <u>ends</u>. This is different from the fiscal year which the provided financials represent, as described below.**
    - 2016 Audited
        - Fiscal Year Ending March 31, 2017 (FYE 2017) - Accrual Basis - 12 months
    - 2017 Audited
        - Fiscal Year Ending March 31, 2018 (FYE 2018) - Accrual Basis - 12 months
    - 2018 Audited
        - Fiscal Year Ending March 31, 2019 (FYE 2019) - Accrual Basis - 12 months
    - Accountant Reviewed Income Statement through September 30, 2019 - Accrual Basis - 6 months
    - Accountant Reviewed Balance Sheet dated September 30, 2019 - Accrual Basis
- Client's Letter of Intent to Finance
- Client's Customer Questionnaire
- Equipment Appraisal – dated April 6, 2020, prepared by Rohul Patel, CMEA of Reliant Equipment Appraisals, LLC, prepared for Client
- Additional documents that were relied up on in this report are located in Section 8 *Additional Documents (if applicable).*
- Information provided by management or the Client, Client's representatives, Company owner (Seller), or Buyer, either in writing, email or verbally.
- Research of analysis of the financial performance of other companies in the same or similar industry.
- Economic statistics published by the government or other sources.
- Industry statistics published by the government or other sources.

The information provided was analyzed and served as a basis for the final value for Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc., and has been deemed to be reliable, true and accurate, by the Client. Any hypothetical assumptions or conditions may have affected the assignment results.

The Appraiser has not used the Company's cash flow statements in the analysis conducted in the report.

The Client, Buyer (if applicable), Company owner, or representatives of any/all of the aforementioned parties (together referred to as 'Parties') may have completed Reliant Business Valuation's intake questionnaire ('Business Valuation Questionnaire'), may have conducted an interview with Neal Patel or an employee of Reliant Business Valuation on the telephone or via email (also referred to as 'Business Valuation Questionnaire'), and in certain cases may have completed a follow up questionnaire with supplemental questions on the telephone or via email ('Supplemental Questionnaire'). All notes and/or material records are kept in the Appraiser's workfile. **<u>There was no site visit made.</u>**

Additional information is referenced throughout the valuation in the footnotes.

## 1.8 Standard of Value: Fair Market Value

The International Glossary of Business Valuation Terms has been adopted by all of the major business appraisal organizations, specifically by the American Institute of Certified Public Accountants, the American Society of Appraisers, The Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and by The Institute of Business Appraisers.

The IRS *Revenue Ruling 59-60* defines fair market value as the following:

> *"...the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts."* [3]

The International Glossary of Business Valuation Terms defines fair market value as the following:

> *"...the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts."* [4]

The key points expressed in the definition above are
1) Hypothetical willing buyer and willing seller
2) Neither party is under the compulsion to buy
3) Arm's length transaction in an unrestricted market
4) Both parties have reasonable knowledge of relevant facts about the company

The points above have been taken into consideration by the Appraiser in developing the value for the interest being valued in this appraisal.

Note: Investment Value is defined as the value to a particular investor based on individual investment requirements and expectations. For this appraisal, there may be a known buyer for the subject business. However, it is assumed that the buyer will bring no additional benefits of ownership when compared to a hypothetical buyer, and will continue to manage the business in a similar fashion as the current management/ownership.

## 1.9 Premise of Value: Going Concern, Liquidation

There are two fundamental bases on which a company can be valued:
1) As a going concern, or
2) As if being liquidated

The International Glossary of Business Valuation Terms defines the concept of premise of value as:[5]

> *"an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; e.g., going concern, liquidation."*

[3] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 2. Background and Definitions, paragraph .02.
[4] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs, Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 913.
[5] Business Valuations Resources, LLC, The International Glossary of Business Valuation Terms. (Business Valuations Resources, LLC, July 2007)

Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. **is appraised using a going concern premise of value, as the business operates in a profitable manner, and this value will result in the greatest economic benefit to the owner.**

## 1.10 Premise of Value: Relevant Factors

The Business Appraisal Standards, published by the Institute of Business Appraisers (IBA), states in Standard Five that all relevant factors should be taken into consideration, including the following:[6]

1) The nature and history of the business.
2) The present economic conditions and the outlook affecting the business, its industry, and the general economy.
3) Past results, current operations, and future prospects of the business.
4) Past sales of interest in the business enterprise being appraised.
5) Sales of similar businesses or interest therein, whether closely-held or publicly-held.
6) The valuation approaches/methods considered and rejected, the approaches/methods utilized, and the research, sources, computations, and reasoning that supports the Appraiser's analyses, opinions and conclusions.
7) Any special factors that affected the opinion of value. Such factors include, but are not limited to, buy-sell agreements, restrictive stock agreements, corporate articles, bylaws and resolutions, partnership agreements, litigation, regulatory compliance, or environmental hazards.
8) Applicable discounts and premiums such as minority interest, control, marketability or lack thereof.
9) When valuing a majority interest in a business on a "going concern" basis, consider whether the business' highest value may be achieved on a liquidation basis.

*Revenue Ruling 59-60*[7] includes eight of the nine factors from above as well.

## 1.11 Extraordinary Assumptions & Hypothetical Conditions

USPAP states in Standard 9(f) and 9(g) that the Appraiser must disclose any and all extraordinary assumptions or hypothetical conditions necessary in the assignment. These may be used for purposes of reasonable analysis, and will be stated in the report where made. All extraordinary assumptions in this report will be in bold. Their use might have a material impact or effect on the assignment results.

## 1.12 Assumptions and Limiting Conditions

The Business Appraisal Standards, published by the Institute of Business Appraisers (IBA), states in Standard Five that all assumptions and limiting conditions should be specified:[8]

This valuation is subject to the following assumptions and limiting conditions, and any intended user that relies on the information contained in this report (either partially or in its entirety) explicitly agrees to all of the following conditions:

- **Acceptance and/or use of this valuation report constitutes acceptance of the following conditions.**

[6] Institute of Business Appraisers, *Business Appraisal Standards,* Sec. 5.3(j). Mandatory Content.
[7] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph .01.
[8] Institute of Business Appraisers, *Business Appraisal Standards,* Sec. 5.3(h). Mandatory Content.

- All of the facts, data, information and/or material to this appraisal assignment ("Facts & Data") used to prepare this report, its forecasts, estimates, analysis, and projections, including those given to the Appraiser by the Client or Company and others associated with the Company (the "Information Provider"), are considered to be reliable but cannot be guaranteed to be accurate.
- Facts & Data provided to the Appraiser have not been audited or verified for accuracy by the Appraiser. The accuracy and validity of the Facts & Data supplied to the Appraiser is the responsibility of the Information Provider,
- All Facts & Data set forth in the report are accepted to be true and accurate and that the Information Provider of such Facts & Data has not knowingly withheld or omitted anything from the Appraiser that could affect the value estimate.
- The Appraiser assumes that there are no hidden or unexpected conditions of the business that would adversely affect value, other than as indicated in this report. The Appraiser has not knowingly withheld or omitted anything from the report that could affect the value estimate.
- *IRS Revenue Ruling 59-609* states, "Detailed profit-and-loss statements should be obtained and considered for a representative period immediately prior to the required date of valuation, preferably five or more years."[9] The Client has provided 42 months of historical financial statements. The Appraiser notes that there may be additional inherent risk in relying on only 42 months of financials (as opposed to the recommended five years/sixty months by the IRS).
- Information Provider has made the Appraiser aware of all relevant facts, data or other conditions that existed at the time of the valuation date, when such Facts & Data are, or should be known to the Information Provider. It is the responsibility of the Information Provider to provide the Appraiser with any additional Facts & Data of which the Information Provider becomes aware, in writing, either subsequent to an initial provision of such Facts and Data before the valuation report is completed, and/or subsequent to the completion of the valuation report. If the Appraiser learns of additional Facts & Data, other than those made available to the Appraiser by the Information Provider, either during the valuation assignment, or after completion of the valuation report, the Appraiser reserves the right to review, and potentially revise, all calculations and statements made within the report and revise his or her opinion based on the revelation of such additional Facts & Data. The Appraiser shall determine, at the Appraiser's sole discretion, whether there will be an additional charge for revision of the valuation report due to any additional Facts & Data.
- This report has been prepared for the stated purpose and function. It is not to be used or relied upon for any other purpose. This report is only valid as of the Effective Date identified herein. No events subsequent to the Effective Date have been taken into consideration.
- The extent of liability for the completeness or accuracy of the data, opinions, comments, recommendations, or conclusions shall not exceed the amount paid to the Appraiser for professional fees and, then, only to the intended user.
- The appraisal estimate of fair market value reached in this report is necessarily based on the definition of fair market value as defined in Section 1.8 *Standard of Value: Fair Market Value.* An actual transaction may be concluded at a higher value or lower value depending on the circumstances surrounding the company, the appraised business interest, or the motivations and knowledge of both the buyers and sellers at that time.
- It should be specifically noted that the valuation assumes the business will be competently managed and maintained by financially sound and prudent owners, over a reasonable period of ownership. This valuation assignment does not entail an evaluation of management's effectiveness, nor is the Appraiser responsible for analyzing events beyond the Effective Date

[9] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph. d.

including, but not limited to, future marketing efforts and other management or ownership actions upon which actual results will depend.

- The Appraiser notes that the transaction type (stock or asset) and the assets and/or liabilities included in the Final Value are based on information extracted from sources provided to the Appraiser, such as a Letter of Intent to Purchase, Purchase Agreement, Business Valuation Questionnaire, and Supplemental Questionnaire, among others, as of the report date. If the terms of the transaction are modified, the Final Value may be impacted. The Appraiser is not obligated to modify or update this report, unless specifically requested to update the report by the Client. Such updates must be mutually agreed upon by Client and Appraiser and are subject to the Appraiser's update fees which are at the sole discretion of the Appraiser.
- No opinion is intended to be expressed within the valuation for matters that require legal or other specialized expertise, investigation, or knowledge beyond that customarily employed by appraisers valuing businesses. The Appraiser is not responsible for any losses incurred by the Company or those associated with the Company, legal, or tax matters relative to the valuation. All values are stated without any reverence to legal claims unless specifically stated.
- The engagement for appraisal, consultation, or analytical service is fulfilled and the total fee is due and payable upon completion of the report. The Appraiser and/or employees of Reliant Business Valuation, LLC are not obligated by reason of this report to provide testimony (expert or fact) before any court or commission, unless mutually agreeable arrangements are made for such testimony, including appraiser's fees, which are at the sole discretion of the Appraiser.
- It is assumed that there are no regulations of any government entity to control or restrict the use of the underlying assets or the company as a whole, unless specifically referred to in the report, and that the underlying assets and the company as a whole will not operate in violation of any applicable government regulations, codes, ordinances, or statutes.
- All titles are assumed to be good and marketable, unless otherwise stated. No investigations of titles to assets or searches for liens against assets have been made by the Appraiser.
- This report may contain prospective financial information, estimates, or opinions that represent the view of the Appraiser about reasonable expectations as of the Effective Date. Such information, estimates, or opinions do not fully reflect the range of factors that may potentially impact the future operations of the Company, including, but not limited to: income, profit, or extraneous events.
- Hazardous substances, if present, can introduce an actual or potential liability that could adversely affect the marketability and value of a business. Such liability may be in the form of immediate recognition of existing hazardous conditions, or future liability that could stem from the release of currently non-hazardous contaminants. In the development of the opinion of value, no consideration was given to such liability or its impact on value unless specifically stated. The Appraiser has not taken into account any and all future environmental considerations and potential liability.
- Possession of this report, or a copy thereof, does not carry with it the right of publication of all or part of it, nor may it be used for any purpose without the previous written consent of the Appraiser, and in any event only with prior written authorization. Every page of this report is copyrighted by Reliant Business Valuation, LLC. Excerpts taken out of context of this report may be misleading or misconstrued.
- Neither all nor any part of the contents of this report shall be disseminated to the public through advertising, public relations, news, sales, or other media without the prior written consent and approval of the Appraiser, which shall be at the sole discretion of the Appraiser.
- The Appraiser will review the [Draft] Purchase Agreement or Letter of Intent to Purchase if such document was made available to the Appraiser, but the Appraiser is not an attorney and has only

relied on this document to extract certain deal terms, such as Buyer, Seller, Price, Allocations, Sale Type (stock or asset) and Non-Compete clauses. Any further analysis is outside of the scope of work of this engagement. Similarly, a Lease may be reviewed only to determine the lease commencement and expiration dates, options to extend and approximate base or gross rental rates. All leases are assumed to have annual rental rate increases of 3% and are expected to have a total term (including options) of at least 10 years. No percentage rent has been accounted for unless specifically provided as part of the Facts & Data.

- An appraisal of fixed assets and/or real estate was not performed by Reliant Business Valuation, LLC. The Appraiser may rely on third party appraisal reports for estimated fair market values of real estate rent and/or fixed assets, if provided by the Information Provider. Where such values are used in this appraisal, no warranty is made with respect to these values. The Appraiser will attempt to only rely on USPAP compliant reports in which the Client is the intended user – although Reliant Business Valuation, LLC is not an intended user, the Client has authorized the Appraiser to utilize information from third party appraisal reports and therefore the Client assumes liability for the validity of such information. If values stated in relied-upon reports are incorrect, the resulting estimate of the value of the subject ownership interest may be affected. If a USPAP compliant equipment appraisal was not available, the Appraiser has relied on the net book value of fixed assets, which may not be reflective of their actual fair market value.
- Public information, purchased private information, and industry statistical information are from sources deemed to be reliable. The Appraiser does not make any representation as to the accuracy or correctness of such information beyond reason and has accepted the information as true without further investigation. Reliant Business Valuation, LLC is not and does not claim to be a guarantor of value. The valuation of closely-held businesses is an imprecise science, with value being a question of fact and varying estimates of value. Reliant Business Valuation, LLC has utilized conceptually sound and accepted approaches and techniques of valuation within the business valuation industry in determining the estimated value included in this report.
- The underlying transaction of the Company may be based on either a minority or majority interest. However, the appraiser has been engaged by the Client to value a 100% interest in the Company. Therefore, the appraiser's scope of work does not include adjustments for minority discounts such as a lack of control or lack of marketability. As such, a minority or majority interest derived from the appraiser's subject valuation may not be equal to the pro-rata share of the 100% value.
- The Company or current owner(s) of the Company may own the real estate from which it operates. In this instance, the appraiser will be required to estimate the fair market rent of the subject real estate or similar business location, as fair market value assumes a hypothetical buyer will not benefit from owning the real estate from which the Company operates. In order to determine the Company's appropriate occupancy costs under a hypothetical buyer, the appraiser may rely on third-party specialists, such as real estate appraisers, or conduct research for comparable properties within the Company's geographic area through online commercial real estate listing sources. The appraiser is not a real estate appraiser. The fair market rental rates estimated by the appraiser are strictly for use in this report and should not be construed as a real estate appraisal or relied upon to establish the rental rates associated with any other specific property.
- In no way is Reliant Business Valuation, LLC or the appraiser recommending that the Client offer financing to the borrower or Company, or that a potential buyer purchase the Company at a certain price. The appraiser is only offering his or her opinion of value about the fair market value of the business as of the Effective Date, and nothing further. No underwriting or analysis has been conducted on the borrower, as all buyers are assumed to be hypothetical buyers, according to the definition of fair market value stated in Section 1.8. By requesting and relying on this report, the

Client agrees not to hold the appraiser responsible for any future loan default. The appraiser recommends that the Client and related parties obtain a second opinion to limit their liability or loss.

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# 2. ANALYSIS OF SUBJECT COMPANY

The Business Appraisal Standards, published by the Institute of Business Appraisers (IBA), states in Standard Five that all relevant factors should be taken into consideration, including the history and nature of the business.[10] The following discussion documents the Appraiser's understanding of the Company's history and current operating environment –**additional relevant facts may have been considered, but remain in the Appraiser's workfile.**

## 2.1 Form of Organization

Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. (dba Blue Diamond Sheet Metal, Diam-N-Blu Mechanical, and Mirage Mechanical Systems) are three S-Corporations formed in the State of New York.

For the purposes of this valuation, the Appraiser will combine the three companies and treat them as one entity (hereafter referred to as "Company").

## 2.2 History of Company

The Company operates as three entities and provides general engineering, metal fabrication, equipment installation, and industrial maintenance. No further information about the Company's history was made available to the Appraiser at the time of the Report Date.

The Company has no subsidiaries, and the Company is not a subsidiary of any other company.

## 2.3 Prior Transactions of the Subject Company

The Business Appraisal Standards, published by the Institute of Business Appraisers (IBA), states in Standard Five that the Appraiser take into consideration "past sales of interest in the business enterprise being appraised."[11] Although there may have been a prior sale of the Company that the Appraiser has not been notified of, it is difficult for the Appraiser to determine whether the sale was an arm's length sale, and what the historical normalized sales and earnings of the Company were immediately preceding that sale. Therefore, the Appraiser will not take into consideration any prior transactions of the Company in the market approach.

## 2.4 Restrictions of Transfer or Litigation

There are no restrictions of transfer or litigation currently pending that would adversely affect the valuation of the Company that the Appraiser has been notified of. Therefore, the Appraiser makes an extraordinary assumption that the value of the Company should not be impacted by any such restrictions or litigation.

The Appraiser assumes the Company and/or the current owner(s) have the necessary licenses and/or permits to operate the business. Furthermore, it is assumed that these licenses and/or permits are in good standing and are not expired.

[10] Institute of Business Appraisers, *Business Appraisal Standards,* Sec. 5.3(j). Mandatory Content. paragraph i.
[11] Institute of Business Appraisers, *Business Appraisal Standards,* Sec. 5.3(j). Mandatory Content. paragraph iv.

## 2.5 Employees

According to the Bank's Customer Questionnaire, the Company has one hundred ten employee(s). Employee turnover at the Company is assumed to be typical for its industry.

Below is a breakdown of the current ownership and their responsibilities. This will be further discussed in Section 4.5 *Financial Statement Adjustments*.

| Owner Name | Hours | Responsibilities |
|---|---|---|
| Rob Belz | 40 | Controller |
| Stephen Dimeglio | 20 | Project Manager - BDSM |
| James Dvorak | 20 | Project Manager - DnB |
| Al LaBella | 40 | Sales Operations |

## 2.6 Management

*Revenue Ruling 59-60* states, "The loss of the manager of a so-called 'one-man' business may have a depressing effect upon the value of the stock of such business…On the other hand…the nature of the business and of its assets may be such that they will not be impaired by the loss of the manager."[12] It is thus important to determine if the management is expendable. As per Section 2.5 and other factors discussed in the report, this is deemed a moderate risk factor.

## 2.7 Location and Equipment

The Company operates from a facility of 53,000 square feet that is located at 1165 Station Road, Medford, NY 11763. The real estate where the Company is located is owned by a separate, but related, holding entity so a rent adjustment is required in the financial analysis portion of this appraisal (Section 4.5 Financial Statement Adjustments), as a hypothetical buyer of the Company will not assume the same rental expenses as the current owner.

The Supplemental Questionnaire states a new drafting program will need to be purchased within the next three years, at an approximate cost of $100,000. The Company typically spends $150,000 to $200,000 on capital expenditures and equipment in a typical year.

## 2.8 Products and Services

The Company provides sheet metal fabrication and installation to customers in the construction industry. The Company also serves as a mechanical contractor specializing in plumbing and HVAC systems. The following is a brief description of the Company: [13]

*The combined workforce of Blue Diamond Sheet Metal and Diam-N-Blu Mechanical established a premier company with a full service metal fabricator and a full service mechanical contractor. We have four executive officers, of which directly oversee the operations of our different divisions – general engineering, metal fabrication, equipment installation and industrial maintenance. Our core of estimators and engineers, have a variety of education and experience in mechanical and civil estimating, mechanical engineering, civil engineering, pipe detailing and equipment installation. They interface closely with our project managers through the setup phase of our projects. At the heart of our construction projects are our project managers who are directly responsible for the project's management and supervision. They*

[12] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph .02(b).
[13] http://www.dnbmechanical.com/index.php/about/

*operate at our main office for smaller projects, or at the jobsite for larger projects. These managers work closely with the client, our project superintendents and key trade foremen.*

*We specialize in large commercial and industrial projects, we design, construct, service and maintain hospitals, satellite medical facilities, laboratories, office buildings, climate controlled warehouses and practically any commercial or industrial facility.*

*The core business includes the following areas of specialty:*

- *Design and Drafting*
- *Sheet Metal Fabrication*
- *Heating Ventilation & Air-Conditioning*
- *Piping*
- *Controls Installation*
- *Service Maintenance*
- *Excellent Safety Record*

The number of customers served by the Company varies from year to year. As per the Supplemental, there are two customers that typically contribute 15% or more to annual sales (Tomco Mechanical and Sound Air Conditioning, which each typically contribute approximately 17% - 18% of sales).

*Whenever a client makes up 15% of a Company's business, it is important to examine the relationship and the subsequent risks related with this client. If the client is only a customer for one non-recurring year, then it is important to note that sales in the year reflect an outlying portion of income. If the client has been a customer for numerous years and is under contract, then the risks associated with the client can be considered moderate and the appraiser expects the client to remain with the Company despite a change in ownership.*

The Company does not have any contracts which guarantee exclusivity or revenue with these clients. The Company has been doing business with Tomco Mechanical for eight years, and Sound Air Conditioning for seven years. These customers are stated to prefer the Company to competitors based on reputation, performance, accountability, and professionalism. **Based on the overall analysis, the Appraiser deems the customer concentration risk associated with the Company to be moderate to high risk factor.**

The Company maintains a well-established website at www.dnbmechanical.com. Business at the Company is not described to be seasonal.

## 2.9 Competition

The appraiser has independently researched three competitors to the Company and has detailed the findings of this search in the table below:

| Company | Description | Competitive Analysis |
|---|---|---|
| AQEL Sheet Metal<br>2305 2nd Avenue<br>New York, NY 10035 | This business offers a wide range of commercial sheet metal products and services. Products offered include chimney and chimney liners, HVAC, round and flat oval, skylights, grilles, | This business is considered to be in direct competition with the Company as it provides similar products |

| | | |
|---|---|---|
| | perforated steel sheets, custom fabrication, and more.[14] | and services. |
| EZ – Ductwork, Inc.<br>1002 Jamaica Avenue<br>Brooklyn, NY 11208 | This business specializes in commercial and residential ductwork and sheet metal fabrication. Products and services offered include ductwork manufacturing, sheet metal manufacture, air conditioning ductwork, kitchen exhaust, sheet metal shop and HVAC. This business has been operating since 1989.[15] | This business is considered to be in direct competition with the Company as it provides similar products and services. |
| B&B Sheet Metal<br>2540 50th Avenue<br>Long Island City, NY 11101 | This business operates as a manufacturer of sheet metal products. Products offered include skylight, cornice, drainage system, wall louver vents, cupolas, ventilator, roof hatch, and more.[16] | This business is considered to be in direct competition with the Company as it provides similar products and services. |

No additional independent analysis of competition was conducted by the appraiser.

## 2.10 Existing Purchase Agreement

The Appraiser has not received an existing Purchase Agreement as of the Report Date. Per the Client's LOI to Finance, the proposed transaction will be a stock transaction for 75% of the Company's shares.

The pending transaction may have changed before the compilation of this valuation, or may change after the Report Date. The Appraiser cannot guarantee the accuracy of the terms above.

## 2.11 Future Prospects for the Business

As per Section 3.2 *Industry Analysis: Overview*, the outlook of the Sheet Metal, Window & Door Manufacturing industry looks positive due to many factors. The industry is closely tied to the construction sector and is subject to its performance. The industry has experienced gradual increases in demand as construction activity has improved. Industry revenue is expected to have increased at an annualized rate of 3.2% to $49.0 billion in the five years to 2019.

The values of residential and private nonresidential construction are expected to have increased during 2019, presenting the industry with opportunities. However, demand from home improvement stores is expected to have only grown marginally in 2019, posing a potential threat to the industry. Due to these factors, IBISWorld projects industry revenue to increase at an annualized rate of 1.2% to $52.0 billion over the five years to 2024. Accordingly, the appraiser notes that the future prospects for the Company appear to be good.

[14] Florida Sheet Metal: https://www.aqelsheetmetal.com/
[15] EZ – Ductwork, Inc.: https://www.ezductwork.com/
[16] B&B Sheet Metal: http://www.bbsheetmetal.com/

# 3. ECONOMIC AND INDUSTRY CONDITIONS

## 3.1 Economic Analysis

*Revenue Ruling 59-60*, promulgated in 1959, addressed a desire by the Internal Revenue Service to set forth fundamental issues appraisers should consider when valuing a closely held business.

According to *Revenue Ruling 59-60*, "Economic analysis is necessary at the valuation date in order to determine how the investing public feels about the future income of the property. Uncertainty about future income increases the risk and affects the value in the future."[17]

*Revenue Ruling 59-60* states "The fair market value of specific shares of stock will vary as general economic conditions change from "normal" to "boom" to "depression", that is, according to the degree of optimism or pessimism with which the investing public regards the future at the required date of appraisal. Uncertainty as to the stability or continuity of the future income from a property decreases its value by increasing the risk of loss of earnings and value in the future."[18] The Ruling goes on to say, "Valuation of securities is, in essence, a prophecy as to the future and must be based on the facts available at the required date of appraisal."[19]

A clear understanding of the economic outlook is important in coming to a valid conclusion of value, and the following sections will summarize the relevant factors in the economy.

### 3.1.1 Overview of the National Economy[20]

General Conditions

Job growth slowed in August to 130,000, and was also revised lower in June (178,000 jobs added) and July (159,000 jobs) by a combined 20,000. Job growth has averaged 156,000 over the past three months, down from 168,000 per month in the year through March 2019 (taking into account preliminary revisions). Private-sector job growth was soft in August at 96,000, down from an average of 124,000 in the previous three months. The unemployment rate held steady at 3.7 percent for a third straight month in August. Outside of a 3.6 percent rate in April and May, this is the lowest the unemployment rate has been in 50 years. One bright spot in August was income. Wage growth picked up as average hourly earnings rose 0.39 percent in August from July, the biggest one-month gain in a year. Wage growth was also revised higher in June and July. Year-over-year growth in wages was 3.2 percent in August, down from an upwardly revised 3.3 percent in July. Wage growth remains well above the pace of inflation.

- The Federal Open Market Committee cut the fed funds rate by 0.25 percentage point in mid-September, to a range of 1.75 to 2.00 percent. This followed a rate cut of the same size in late July. The September 18 FOMC statement noted that economic conditions remain solid, and that the most likely outcome is continued growth, but noted uncertainty about the outlook. Given this, and inflation that is lower than the central bank would like, the FOMC decided to cut the fed funds rate. In recent public statements Fed Chair Powell has discussed a "mid-cycle adjustment," suggesting that the FOMC may cut rates a few times to support growth, but not engage in a full-blown easing cycle. There was more dissension than usual in September; one FOMC member favored a bigger rate cut, while two favored no rate cut.

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[17] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 412.
[18] Internal Revenue Service, *Revenue Ruling 59-60*, Sec. 3. Approach to Valuation, paragraph .02.
[19] Internal Revenue Service, *Revenue Ruling 59-60*, Sec. 3. Approach to Valuation, paragraph .03.
[20] PNC National Economic Outlook – Executive Summary September 2019 from: https://tinyurl.com/y576tnvx

- Housing data have been better in recent months. Housing starts rose 12 percent in August from July, including a 4 percent increase in single-family starts. Housing permits were also higher over the month, up 8 percent, including an almost 6 percent increase in single-family permits; this points to further increases in homebuilding in the near future. Existing home sales also rose in August. A decline in mortgage rates of more than one percentage point since the fall of 2018, as well as the good labor market, are boosting home sales and construction. Residential construction has been a negative for the economy for most of the past two years, but should contribute to growth in the third quarter.

### 3.1.2 Overview of the State Economy

Key Points about the State of New York to note:[21]

- State job growth rose 1.1% in October 2019 from a year ago; national job growth rose 1.4%
- State unemployment averaged 3.9% in October 2019; the national average was 3.6%
- Personal income rose 3.9% to $1392.9 trillion in Q2 2019 from a year ago.
- Tax revenue increased 4.9% in Q2 2019 from a year ago.
- Exports fell 13.4% to $50.9 billion in the first eight months of 2019 from a year ago.

<u>The Company is not a location specific business and can be operated from any other general office space without causing disruption to the Company's operation and revenues. Therefore, the location will not have a major impact on the value of the Company.</u>

[21] First Research State Profile, retrieved from: http://www.firstresearch.com/

Aluminum, a very lightweight yet relatively strong metal, is used by this industry to create window frames and certain other sheet metal products. Volatile aluminum prices affect industry profit margins, since increased prices cannot always be passed on to the consumer. As per the graph below, the world price of aluminum has decreased since the beginning of 2019. As of March 2020, the world price of aluminum was registered at $1545.50 per ton.

World Price of Aluminum:[22]


[22] World Price of Aluminum, retrieved from: http://www.tradingeconomics.com/commodity/aluminum

The largest market for industry products is the commercial construction market, which purchases sheet metal products such as air ducts, grilles, metal moldings for acoustical suspension ceiling systems, emergency egress doors and exits for use during construction. Consequently, the value of private nonresidential construction is the primary driver of industry performance. The value of private nonresidential construction is expected to have increased in 2019, representing a potential opportunity for the industry. The residential construction market purchases industry products such as sheet metal air conditioning ducts, garage doors and windows. Consequently, expansion in the residential construction market increases demand for industry products. The value of residential construction is expected to have decreased in 2019.

According to the chart below, the value of residential construction has increased by 9.2% to over $562.27 billion in January 2020 from over $514.89 billion in January 2019. The value of private nonresidential construction has increased by 0.5% to approximately $467.95 billion from over $465.82 billion in the same time period. The total value of construction has increased by 6.8% from over $1.282 trillion in January 2019 to over $1.369 trillion in January 2020. As the values of total and private nonresidential construction increase, so will the demand for industry services.

Value of Construction – Seasonally Adjusted Annual Rate (in millions):[23]

| | | | | | | | Percent change Jan 2020 from - | |
|---|---|---|---|---|---|---|---|---|
| Type of Construction | Jan 2020p | Dec 2019r | Nov 2019r | Oct 2019 | Sep 2019 | Jan 2019 | Dec 2019 | Jan 2019 |
| **Total Construction** | 1,369,223 | 1,345,467 | 1,342,490 | 1,320,768 | 1,315,229 | 1,282,491 | 1.8 | 6.8 |
| Residential | 562,273 | 551,028 | 542,838 | 532,521 | 529,455 | 514,893 | 2.0 | 9.2 |
| Nonresidential | 806,950 | 794,439 | 799,653 | 788,266 | 785,775 | 767,598 | 1.6 | 5.1 |
| Lodging | 30,615 | 31,815 | 32,390 | 33,457 | 32,590 | 33,136 | -3.8 | -7.6 |
| Office | 80,298 | 80,048 | 80,318 | 79,999 | 80,109 | 78,211 | 0.3 | 2.7 |
| Commercial | 88,340 | 87,061 | 87,935 | 86,330 | 85,604 | 83,983 | 1.5 | 5.2 |
| Health care | 44,097 | 44,263 | 44,322 | 43,918 | 44,038 | 45,909 | -0.4 | -4.1 |
| Educational | 98,287 | 98,534 | 99,886 | 101,613 | 100,602 | 99,010 | -0.3 | -0.7 |
| Religious | 3,014 | 2,916 | 3,136 | 2,920 | 2,845 | 3,234 | 3.4 | -6.8 |
| Public safety | 10,946 | 10,878 | 10,809 | 10,873 | 10,508 | 8,738 | 0.6 | 25.3 |
| Amusement and recreation | 27,268 | 27,354 | 27,908 | 27,325 | 27,082 | 26,534 | -0.3 | 2.8 |
| Transportation | 56,656 | 55,026 | 56,087 | 54,984 | 55,750 | 53,738 | 3.0 | 5.4 |
| Communication | 23,618 | 23,739 | 23,489 | 23,118 | 23,559 | 23,432 | -0.5 | 0.8 |
| Power | 106,672 | 103,614 | 102,781 | 98,820 | 99,353 | 99,093 | 3.0 | 7.6 |
| Highway and street | 104,252 | 98,890 | 96,678 | 94,429 | 97,514 | 93,318 | 5.4 | 11.7 |
| Sewage and waste disposal | 27,022 | 26,688 | 26,525 | 26,721 | 27,178 | 23,919 | 1.2 | 13.0 |
| Water supply | 18,200 | 18,019 | 18,263 | 17,799 | 17,074 | 13,498 | 1.0 | 34.8 |
| Conservation and development | 10,940 | 9,934 | 9,795 | 9,774 | 9,478 | 8,793 | 10.1 | 24.4 |
| Manufacturing | 76,727 | 75,658 | 81,441 | 78,186 | 72,402 | 72,958 | 1.4 | 5.2 |
| **Total Private Construction**[1] | 1,022,736 | 1,007,644 | 1,006,752 | 986,322 | 979,976 | 974,908 | 1.5 | 4.0 |
| Residential | 554,785 | 543,578 | 535,764 | 525,269 | 522,540 | 509,091 | 2.1 | 9.0 |
| Nonresidential | 467,953 | 464,066 | 470,988 | 461,053 | 457,436 | 465,818 | 0.8 | 0.5 |
| Lodging | 29,481 | 30,605 | 31,025 | 32,248 | 31,391 | 32,217 | -3.7 | -8.5 |
| Office | 68,870 | 68,771 | 68,626 | 68,733 | 68,901 | 68,572 | 0.1 | 0.4 |
| Commercial | 84,112 | 82,929 | 84,101 | 81,701 | 81,066 | 79,716 | 1.4 | 5.5 |
| Health care | 35,363 | 35,245 | 35,257 | 34,958 | 34,957 | 37,229 | 0.3 | -5.0 |
| Educational | 16,803 | 17,602 | 18,176 | 18,518 | 18,936 | 20,752 | -4.5 | -19.0 |
| Religious | 3,014 | 2,916 | 3,136 | 2,920 | 2,845 | 3,234 | 3.4 | -6.8 |
| Amusement and recreation | 12,966 | 13,273 | 13,763 | 13,477 | 13,407 | 14,724 | -2.3 | -11.9 |
| Transportation | 16,836 | 16,310 | 16,151 | 16,401 | 16,843 | 18,022 | 3.2 | -6.6 |
| Communication | 23,530 | 23,611 | 23,378 | 23,022 | 23,430 | 23,318 | -0.3 | 0.9 |
| Power | 99,192 | 95,967 | 94,826 | 91,853 | 92,127 | 93,828 | 3.4 | 5.7 |
| Manufacturing | 76,447 | 75,427 | 81,076 | 75,866 | 72,099 | 72,783 | 1.4 | 5.0 |

[23] Value of Construction, retrieved from: http://www.census.gov/construction/c30/pdf/totsa.pdf

Steel is one of the primary raw materials used in this industry, and its price can fluctuate wildly. Higher prices damage industry profitability because companies cannot always pass on increased prices to the consumer. The world price of steel is expected to have declined in 2019. As seen in the chart below, the global price of carbon steel was at $621 per metric ton in October 2019, down from $645 per metric ton in September 2019. The global price of composite stainless-steel grade 304 was at $2,622 per metric ton in October 2019, an increase from $2,547 per metric ton in September 2019.

Global Composite Steel Price and Index – US$/metric ton:[24]

| Month | CARBON STEEL PRICE | CARBON STEEL INDEX | STAINLESS STEEL 304 PRICE | STAINLESS STEEL 304 INDEX |
|---|---|---|---|---|
| Oct-19 | 621 | 155.6 | 2622 | 139.7 |
| Sep-19 | 645 | 161.7 | 2547 | 135.7 |
| Aug-19 | 657 | 164.7 | 2406 | 128.2 |
| Jul-19 | 660 | 165.3 | 2381 | 126.9 |
| Jun-19 | 668 | 167.4 | 2406 | 128.2 |
| May-19 | 687 | 172.2 | 2476 | 132.0 |
| Apr-19 | 711 | 178.1 | 2507 | 133.1 |
| Mar-19 | 712 | 178.4 | 2442 | 130.1 |
| Feb-19 | 709 | 177.7 | 2371 | 126.4 |
| Jan-19 | 716 | 179.4 | 2346 | 125.0 |
| Dec-18 | 731 | 183.2 | 2414 | 128.6 |
| Nov-18 | 749 | 187.7 | 2527 | 134.7 |

[24] Global Composite Steel Price and Index, retrieved from: http://www.worldsteelprices.com/

### 3.1.3 Economic Outlook[25]

| | 1Q'19a | 2Q'19p | 3Q'19f | 4Q'19f | 1Q'20f | 2Q'20f | 3Q'20f | 4Q'20f | 2018a | 2019f | 2020f | 2021f |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Output & Prices* | | | | | | | | | | | | |
| Real GDP (*Chained 2012 Billions $*) | 18927 | 19023 | 19126 | 19209 | 19278 | 19348 | 19434 | 19536 | 18638 | 19071 | 19399 | 19777 |
| **Percent Change Annualized** | **3.1** | **2.0** | **2.2** | **1.7** | **1.4** | **1.5** | **1.8** | **2.1** | **2.9** | **2.3** | **1.7** | **2.0** |
| CPI (*1982-84 = 100*) | 253.3 | 255.1 | 255.9 | 267.0 | 258.3 | 259.6 | 260.8 | 262.1 | 251.1 | 255.4 | 260.2 | 265.6 |
| **Percent Change Annualized** | **0.9** | **2.9** | **1.3** | **1.7** | **2.0** | **1.9** | **2.0** | **2.1** | **2.4** | **1.7** | **1.9** | **2.1** |
| *Labor Markets* | | | | | | | | | | | | |
| Payroll Jobs (*Millions*) | 150.7 | 151.1 | 151.5 | 151.7 | 151.9 | 152.1 | 152.3 | 152.8 | 149.1 | 151.3 | 152.2 | 153.4 |
| **Percent Change Annualized** | **1.7** | **1.2** | **1.1** | **0.5** | **0.5** | **0.5** | **0.6** | **0.8** | **1.7** | **1.5** | **0.6** | **0.8** |
| Unemployment Rate (*Percent*) | 3.9 | 3.6 | 3.7 | 3.8 | 3.9 | 3.9 | 4.0 | 4.0 | 3.8 | 3.8 | 4.0 | 4.0 |
| *Interest Rates (Percent)* | | | | | | | | | | | | |
| Federal Funds | 2.40 | 2.40 | 2.18 | 1.71 | 1.63 | 1.63 | 1.63 | 1.63 | 1.83 | 2.17 | 1.63 | 1.63 |
| Treasury Note, 10-year | 2.65 | 2.33 | 1.75 | 1.71 | 1.77 | 1.81 | 1.85 | 1.90 | 2.91 | 2.11 | 1.83 | 2.00 |

According to the table above, the real GDP is forecasted to increase at a rate of 2.0% in the second quarter of 2019, then at a rate of 2.2% for the third quarter and 1.7% for the fourth quarter of 2019 (percentage change annualized).

### 3.1.4 How the Economy Affects Value

Gross Domestic Product (GDP) measures growth of the economy. Most small to medium sized businesses are more concerned with growth of consumer spending and disposable income, things that are more likely to be transferred directly to business sales. Inflation and unemployment are major economic factors that can adversely affect businesses.

Key Points to note:

- Real GDP to grow 2.3% in 2019, 1.7% in 2020, and 2.0% in 2021
- Consumer prices will increase 1.7% in 2019, 1.9% in 2020, and 2.1% in 2021
- Unemployment rate will be 3.8% in 2019, 4.0% in 2020, and 4.0% in 2021
- Federal Funds rate will be approximately 2.17 in 2019, 1.63 in 2020, and 1.63 in 2021

There are two main categories of risks that affect the valuation of any company. These are the Business Risk, or the volatility of the operating income, and Financial Risk, or the risk of going bankrupt.

**Overall, the appraiser notes that the risk impact resulting from the economic outlook remains moderate.**

[25] PNC National Economic Outlook – Executive Summary September 2019 from: https://tinyurl.com/y576tnvx

## 3.2 Industry Analysis: Overview

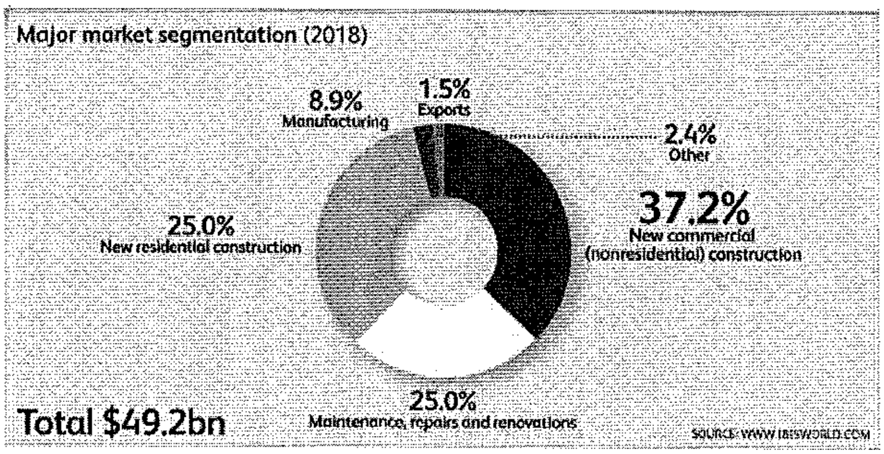
*Revenue Ruling 59-60* states "A sound appraisal of a closely held stock must consider current and prospective economic conditions as of the date of appraisal, both in the national economy and in the **industry or industries** with which the corporation is allied."[26]

The North American Industry Classification System or NAICS is used by businesses and governments to classify and measure economic activity in Canada, Mexico and the United States. The appraiser analyzes the industry that the Company best falls into as: IBISWorld Category 33232 (Sheet Metal, Window & Door Manufacturing in the US). The following Industry Report (including graphs and tables) is dated July 2019 and was derived from IBISWorld, Inc.[27]

### 3.2.1 Characteristics of Industry

Industry Overview

Operators in this industry manufacture metal products including metal-framed windows (using purchased glass), metal doors, sheet metal work and ornamental and architectural metal products. These products are primarily used in building construction, maintenance and repair.




Operators in the Sheet Metal, Window and Door Manufacturing industry produce windows and doors, sheet metal products and ornamental and architectural metalwork. The Construction sector (IBISWorld report 23) comprises the overwhelming majority of demand for industry products; therefore, the industry's performance over the five years to 2019 reflects this downstream market's significant growth during the period. Strong demand from residential construction and renovation has boosted industry sales during the five-year period, while industry profit has grown despite volatile input prices. Overall, industry revenue is expected to grow at an annualized rate of 3.2% to $49.0 billion over the past five years, despite a decrease of 3.2% in 2019 due to an anticipated drop in the price of aluminum.

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[26] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph .02(b).

[27] This product has been supplied by IBISWorld Inc. ('IBISWorld') solely for use by its authorized licenses strictly in accordance with their license agreements with IBISWorld. IBISWorld makes no representation to any other person with regard to the completeness or accuracy of the data or information contained herein, and it accepts no responsibility and disclaims all liability (save for liability which cannot be lawfully disclaimed) for loss or damage whatsoever suffered or incurred by any other person resulting from the use of, or reliance upon, the data or information contained herein.

Growth in the US construction market has boosted downstream demand for industry products and expanded industry profit. Private nonresidential construction activity, a major driver of demand for industry goods, has increased at an annualized rate of 0.3% over the five years to 2019, including particularly strong growth of 5.0% in 2018. However, the industry contends with increasing competition from imports, which grew at an annualized rate of 6.4% to $2.0 billion during the same five-year period. Working against profit margins over the past five years has been the volatile prices of aluminum and steel, key industry inputs. Nevertheless, the average industry profit margin, measured as earnings before interest and taxes, is estimated at 7.1% of revenue in 2019, up from 5.4% in 2014.

Over the five years to 2024, demand for sheet metal products from downstream markets will continue to rise, albeit at a lower rate than in the current period, as construction activity is projected to slow. Consequently, industry revenue is anticipated to increase at an annualized rate of 1.2% to $52.0 billion over the five years to 2024. Furthermore, competition from imports, while projected to grow only marginally over the next five years, still poses some threat to the industry. Additionally, the prices of both steel and aluminum are expected to grow at slow rates over the next five years, leading to stabilized industry profit margins, which are expected to remain at 7.1% of revenue in 2024.

Products and Services

The Sheet Metal, Window and Door Manufacturing industry manufactures a wide range of fabricated metal products for architectural, ornamental, structural and industrial uses. As a result, no product category or industry operator dominates the industry as a whole.

Sales of metal windows, doors and associated trimming and accessories account for a combined 26.8% of revenue in 2019. This segment's products are used primarily in building construction, maintenance and repair, and include metal window frames, doors and garage doors. Metal doors are used in a range of construction applications in the residential, commercial and industrial sectors and account for the largest share of door and window demand. Metal windows and doors are expected to continue to be the preferred choice over other door and window types over the next five years. Aluminum and steel windows are common in commercial and industrial buildings (i.e. storefronts, office buildings, and factories) because the material is very durable and has a long service life. This enables operators to make the window frame and trimming extremely thin, which maximizes the glass area. Thermal break barriers and multipaned glass are also used alongside aluminum window frames. As these features become more energy-efficient and attractive to modern homeowners, demand for aluminum-based window frames is likely to increase. The trend toward bridging interior and exterior spaces with wide-opening doors and windows, such as bi-fold doors and lift and slide doors, is also driving demand for steel windows and doors in the residential market, especially for high-end homes.

Over the past three decades, consumer preference has shifted gradually from garage doors made from wood or fiberglass to garage doors made from steel. Metal garage doors are generally stronger, lighter and have fewer maintenance requirements than conventional wooden doors. Metal doors have also been enhanced in recent years, with the inclusion of insulated double-sided steel, new spring systems, sophisticated window options and improved safety features.

Sheet metal products are used in virtually all phases of building construction and have many uses in improvements and repairs for existing structures. All other sheet metal products (excluding the above-mentioned window and door product segment) account for the remaining 73.2% of revenue. Products within this segment include sheet metal roofing, flooring (i.e. grates), metal gutters and other roof drainage equipment. These products are used in roof installation and maintenance; siding; rain gutters; downspouts; and skylights. Other products in this segment include awnings, canopies, casings, chutes,

flumes and furnace casings. Sales of sheet metal products have increased in line with growth in the number of industrial, commercial and residential structures to be built over the next five years. The following sections provide a more in-depth overview of other major product groups within this industry.

Most residential and commercial buildings that have a central heating, ventilating and air-conditioning (HVAC) system use sheet metal ducts or pipes to distribute heated or cooled air from a furnace or air conditioner (AC) unit to vents throughout the building. Therefore, demand for this product segment is largely driven by overall private nonresidential construction activity and residential housing starts. In addition, sales for sheet metal ducts are partially driven by renovation and maintenance work within existing buildings. In particular, requests for more energy-efficient HVAC systems in older buildings has boosted demand for sheet metal ducts, which are typically replaced along with older furnaces or AC units during renovation work. Consequently, this product segment has grown to a 9.4% share of total industry revenue in 2019.

The primary types of sheet metal enclosures include radiator shield enclosures and sheet metal casings for large industrial machinery, commercial networking equipment and certain consumer appliances. Sheet metal radiator shield enclosures are used as a complementary product to protect and cover radiators and sheet metal casings are predominantly used outside the construction industry for a variety of products, including electronics. This segment was less affected by the housing bubble due to the varied use of sheet metal casings. However, demand for these products has grown at a slower pace than demand for sheet metal used in construction during the five-year period, causing this segment to shrink as a percentage of revenue to 6.3% in 2019.

All other ornamental and architectural metal products are included in this segment. Among them are miscellaneous architectural metalwork products, such as iron, steel and aluminum stairs, emergency staircases and fire escapes, balcony railings, banisters, steel siding, fences, gates, window guards and open steel flooring. Such products are used in residential and commercial facilities both for their durability and for aesthetic reasons. Architectural trends in residential construction largely drive demand for this segment. Some regions of the country appreciate the traditional aesthetics lent by details such as iron railings, staircases, fences, gates and balconies. In addition to overall trends in architectural preferences, demand for fire escape staircases, fire-rated doors and emergency exits is driven by building occupancy and fire codes, which typically require emergency egress structures to be made from fire-resistant metal rather than wood, plastic or fiberglass.

The remaining 2.7% share of industry revenue is generated by sales of sheet metal grills, diffusers and moldings used in acoustical suspension systems. The vast majority of modern commercial buildings and office spaces have acoustical suspension ceilings (also known as a dropped ceiling), where metal molding is used to support a grid of lightweight ceiling tiles. Consequently, demand for this product segment is primarily driven by private nonresidential construction and commercial building maintenance and renovation activity.

Industry Cost

Cost structures can vary widely among Sheet Metal, Window and Door Manufacturing industry players, depending on size, scale of production, ease of access to production inputs, level of technology and capital investment. Typically, the larger a manufacturer is, the lower per unit cost of production tends to be. The following cost structure illustrates the average expenses typically incurred by metalworkers operating in this industry

Labor costs represent the second-largest expense for industry manufacturers and are estimated to account for 20.8% of revenue in 2019. This figure is down from 2014, when wages made up an estimated 21.8% of revenue. In response to improved operating conditions and growing demand since 2014, industry operators have engaged in hiring activity, with total industry employment expected to rise an annualized 1.1% over the five years to 2019. However, total wages have increased at a slower pace than industry revenue during this period, accounting for the slight drop in wages' share of revenue.

Purchases typically constitute the largest percentage of industry costs, accounting for an estimated 46.0% of revenue in 2019. Key production inputs such as steel and aluminum represent the biggest expenses, and their prices are largely a function of the world market, fluctuating with supply and demand. Steel and aluminum prices have both fluctuated significantly in recent years, often accounting for a larger portion of purchases and driving down profit margins. The construction sector accounts for a significant portion of the total demand for aluminum. Surges in residential or commercial construction can increase demand for aluminum, resulting in higher prices, while housing slumps or slow nonresidential construction can lead to lower aluminum prices. While steel prices have risen on average over the past five years as a whole, prices have been extremely volatile, making it difficult for industry manufacturers to effectively plan product pricing and production orders.

IBISWorld estimates that average profit margins (calculated as income before interest and taxes) will account for 7.1% of industry revenue in 2019, a significant jump from 5.5% in 2014, as renewed demand from the construction sector has boosted revenue growth to outpace rising wages and input prices. Industry operators encountered poor operating conditions during the first half of the five-year period because of depressed US construction spending and volatility in the price of key inputs such as steel and aluminum. Slow recovery within the construction sector and intensifying internal competition forced industry operators to reduce prices, eroding profit margins. Some companies operated at a loss, as profit margins varied drastically between companies and segments within the industry. However, increases in aluminum and steel prices in the latter half of period have coincided with the uptick in demand from residential and nonresidential building markets, somewhat tempering growth in profit margins from 2014 onward.

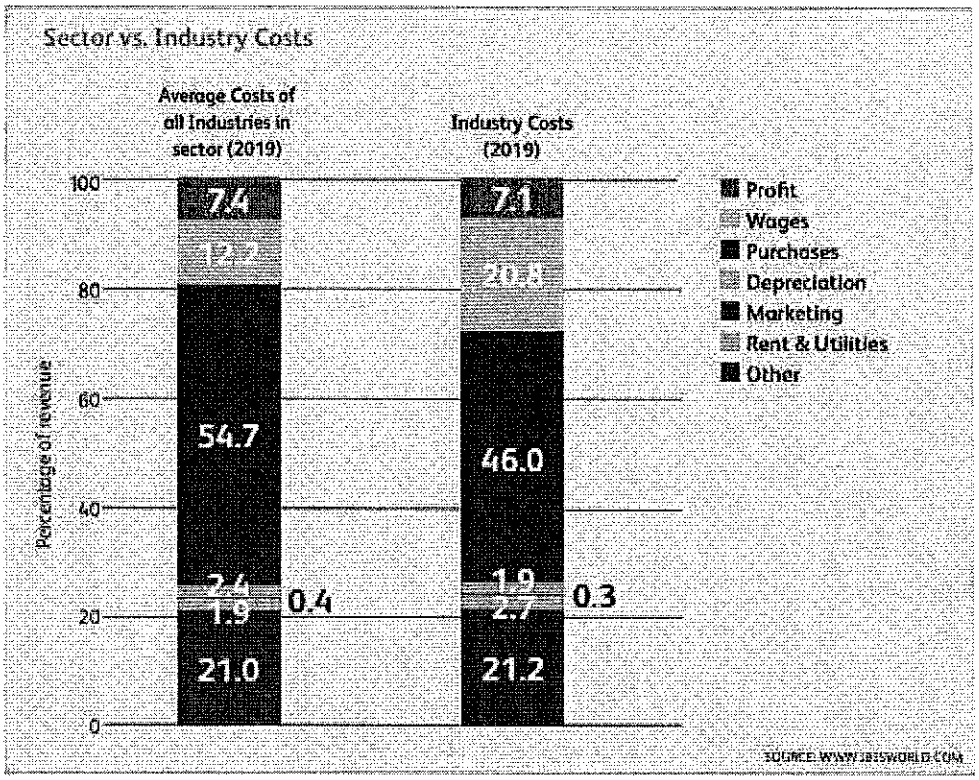
Depreciation costs for the average industry manufacturer are expected to account for 1.9% of revenue in 2019, relatively unchanged since 2019. Depreciation costs vary depending on the size of the operator. Smaller companies, which tend to rely on more labor intensive production processes, typically hire highly skilled employees that can perform a multitude of functions ranging from computer-aided design (CAD) to operating advanced computer numerical control (CNS) machines. However, larger companies are more likely to invest in advanced, expensive metal shaping equipment, which requires specialized employees who typically perform only one major role within the company. In general, larger companies incur higher depreciation costs than smaller companies.

Marketing is expected to account for 0.3% of industry revenue in 2019.

Rent expenses are estimated to account for a combined 1.8% of industry revenue in 2019.

Utility expenses are accounted for 0.9% of industry revenue in 2019.

All other expenses are expected to account for the remaining 21.2% of industry revenue. These costs include personnel and property insurance, expenses related to distribution and warehousing, taxes and research and development.




Recent Industry Performance
The Sheet Metal, Window and Door Manufacturing industry has benefited from growing downstream demand over the five years to 2019, especially from construction markets. Growth in housing starts and nonresidential renovation activity has boosted demand within the construction sector, which accounts for the majority of industry sales. Overall, the value of construction has grown 1.9% during the five-year period, fueling healthy growth for the industry. Nonresidential construction activity has also recently increased due to growth in certain domestic manufacturing markets and improved business sentiment. Moreover, stabilization in the price of aluminum and increases in the price of steel, key inputs, have pushed industry operators to raise selling prices of their products. As a result, industry revenue is expected to increase at an annualized rate of 3.2% to $49.0 billion over the five years to 2019. However, this includes an expected 3.2% decline in revenue in 2019 due to an anticipated sharp drop in the price of aluminum.

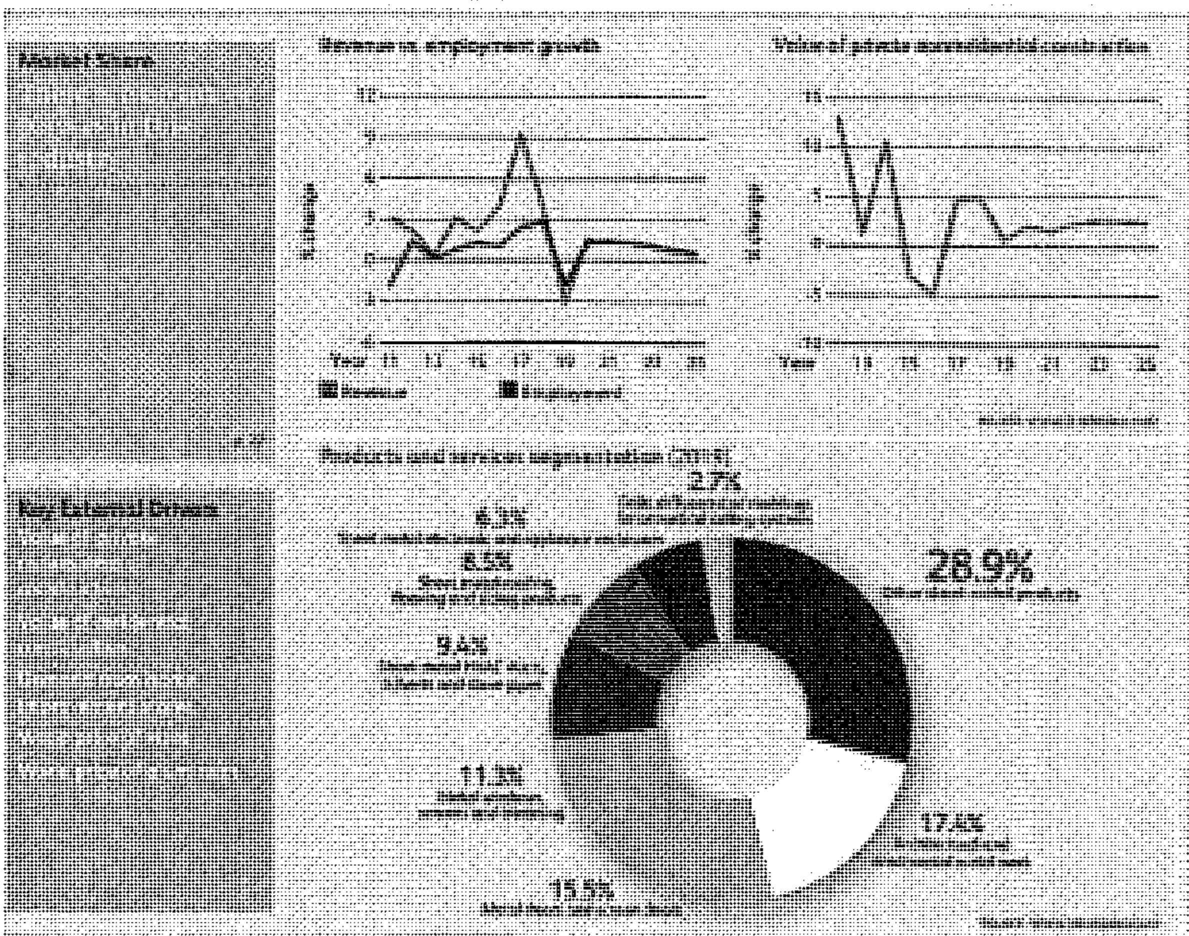
### 3.2.2 Industry Outlook

Industry Outlook
The Sheet Metal, Window and Door Manufacturing industry is poised for more moderate growth as rising demand from the downstream construction sector slows. Revenue is expected to increase at an annualized rate of 1.2% to $52.0 billion over the five years to 2024. Continued growth in residential and commercial construction and higher consumer spending on home renovations and improvements will drive demand for industry products. Increased stability in key input costs are expected to enable manufacturers to maintain desired selling prices and stable profit margins.

Below is a snapshot of the industry:

## Key Statistics Snapshot

| Revenue | Annual Growth 14–19 | Annual Growth 19–24 |
|---|---|---|
| $49.0bn | 3.2% | 1.2% |
| **Profit** | **Exports** | **Businesses** |
| $3.5bn | $713.1m | 7,159 |




## Industry Structure

| | | | |
|---|---|---|---|
| Life Cycle Stage | Mature | Regulation Level | Light |
| Revenue Volatility | Medium | Technology Change | Medium |
| Capital Intensity | Low | Barriers to Entry | Medium |
| Industry Assistance | Medium | Industry Globalization | Low |
| Concentration Level | Low | Competition Level | Medium |

**Over the five years to 2024, IBISWorld forecasts that industry revenue will increase at an average annual rate of 1.2% to $52.0 billion.**

**The business and financial risk associated with the industry are considered to be low because of its recent historical growth and positive future sales outlook.**

# 4. FINANCIAL ANALYSIS OF THE SUBJECT COMPANY

## 4.1 Financial Statements

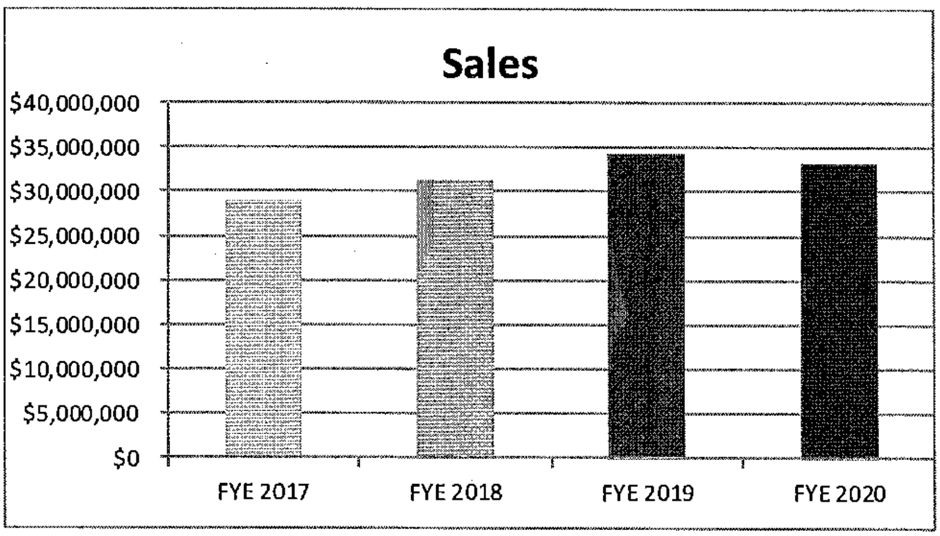
The documents listed in Section 1.7 *Principal Sources of Information* have been used in the analysis section of this report are assumed to be accurate. The documents provided are subject to the statements provided in Section 1.12 *Assumptions and Limiting Conditions*.

## 4.2 Revenue and Earnings History

A good way to get an overview of the financials for Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. is to look at the following two graphs.

The first shows the annual revenues (sales) through FYE 2020:

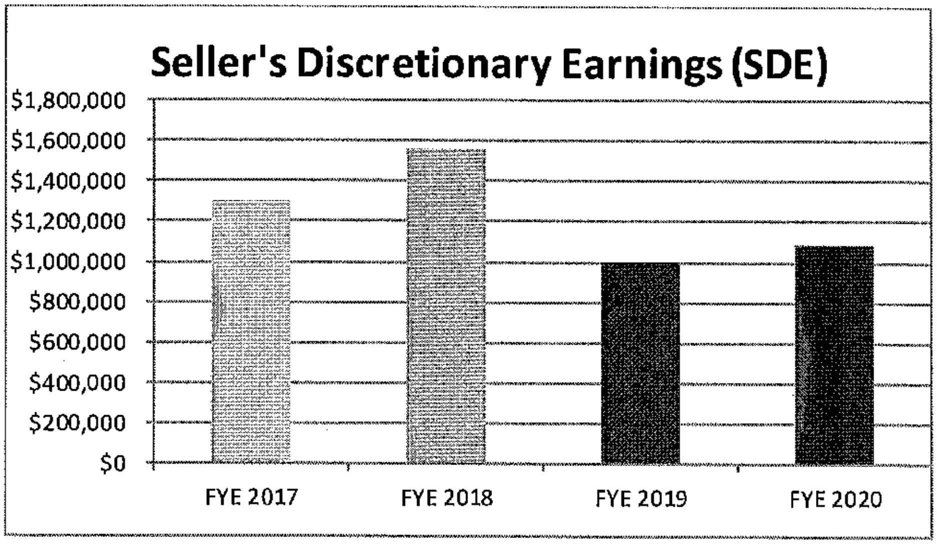
| | 2016 Audited **FYE 2017** | 2017 Audited **FYE 2018** | 2018 Audited **FYE 2019** | Projected - Yr 1 **FYE 2020** |
|---|---|---|---|---|
| Sales | $28,828,055 | $31,192,721 | $34,229,937 | $33,224,648 |
| Change Year Over Year | N/A | 8.2% | 9.7% | -2.9% |




The Company's sales have increased 8.2% in FYE 2018 and 9.7% in FYE 2019. As per the Supplemental Questionnaire, the increase in sales is due to the numbers of bids won.

The second graph shows the Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA) plus Owner's Compensation, which equals Seller's Discretionary Earnings.

| | 2016 Audited<br>**FYE 2017** | 2017 Audited<br>**FYE 2018** | 2018 Audited<br>**FYE 2019** | Projected - Yr 1<br>**FYE 2020** |
|---|---|---|---|---|
| Seller's Disc. Earnings | $1,308,051 | $1,565,014 | $1,003,390 | $1,088,301 |
| Change Year Over Year | N/A | 19.6% | -35.9% | 8.5% |




EBITDA is calculated based on the adjusted pre-tax net income, which gives a better overall view of the cash flow available to the owner before adding back owner's compensation. Owner's Compensation (adjusted for market compensation) is then added to EBITDA to arrive at Seller's Discretionary Earnings (SDE). This is the true cash flow of the Company assuming a full time owner operator. The normalization adjustments that were made will be discussed in detail in Section 4.5 *Financial Statement Adjustments.*

In order to analyze the subject business's revenue and income streams and accurately project future sales and earnings, the Appraiser must review the historical income statement and balance sheets.

The column on the far right of Section 4.3 *Income Statement* and Section 4.6 *Balance Sheets* are industry averages (percentages of revenues or total assets) that are obtained from RMA Annual Statements Studies (Valuation Edition 2019-2020). This data is extracted from the table in Section 4.7 *Industry Ratio Analysis.* The Appraiser includes this column to make it easy to compare the actual performance of the subject company to the industry as a whole.

## 4.3 Income Statements- Historical

The historical income statements along with the most recent income statement provided (actual if full year, projected if partial year) are depicted in the table below. The most recent income statement will be further analyzed in the next section.

| *Accrual Basis* | 2016 Audited FYE 2017 *12 months* | | 2017 Audited FYE 2018 *12 months* | | 2018 Audited FYE 2019 *12 months* | | Projected FYE 2020 *12 months* | | RMA NAICS 332322 |
|---|---|---|---|---|---|---|---|---|---|
| Sales | $ 28,828,055 | 100% | $ 31,192,721 | 100% | $ 34,229,937 | 100% | $ 33,224,648 | 100% | 100.0% |
| Cost of Goods Sold | 24,637,312 | 85.5% | 26,357,569 | 84.5% | 29,817,374 | 87.1% | 28,707,774 | 86.4% | 76.7% |
| Gross Profit | 4,190,743 | 14.5% | 4,835,152 | 15.5% | 4,412,563 | 12.9% | 4,516,874 | 13.6% | 23.3% |
| Other Income | - | 0.0% | 2 | 0.0% | 8 | 0.0% | 58 | 0.0% | |
| Expenses | | | | | | | | | |
| Officer Compensation | 434,389 | 1.5% | 445,415 | 1.4% | 445,415 | 1.3% | 445,415 | 1.3% | |
| Salaries & Wages | 590,711 | 2.0% | 586,312 | 1.9% | 378,372 | 1.1% | 367,260 | 1.1% | |
| Repairs & Maintenance | 31,295 | 0.1% | 86,096 | 0.3% | 34,614 | 0.1% | 33,597 | 0.1% | |
| Bad Debt | - | 0.0% | 10,893 | 0.0% | - | 0.0% | - | 0.0% | |
| Rents | 416,712 | 1.4% | 523,192 | 1.7% | 462,019 | 1.3% | 475,880 | 1.4% | |
| Taxes & Licenses | 88,088 | 0.3% | 113,220 | 0.4% | 130,288 | 0.4% | 126,462 | 0.4% | |
| Interest | 142,618 | 0.5% | 148,644 | 0.5% | 155,765 | 0.5% | 136,794 | 0.4% | |
| Depreciation | 79,718 | 0.3% | 79,862 | 0.3% | 179,023 | 0.5% | 179,023 | 0.5% | |
| Advertising | 3,092 | 0.0% | 14,464 | 0.0% | 35,334 | 0.1% | 34,296 | 0.1% | |
| Benefits / Pension Plan | 141,001 | 0.5% | 187,248 | 0.6% | 96,565 | 0.3% | 93,729 | 0.3% | |
| Amortization | 4,104 | 0.0% | 2,052 | 0.0% | - | 0.0% | - | 0.0% | |
| Auto | 304,090 | 1.1% | 363,155 | 1.2% | 293,897 | 0.9% | 285,266 | 0.9% | |
| Insurance | 388,386 | 1.3% | 309,444 | 1.0% | 744,542 | 2.2% | 781,769 | 2.4% | |
| Travel & Entertainment | 265,053 | 0.9% | 291,917 | 0.9% | 298,274 | 0.9% | 289,514 | 0.9% | |
| Consulting Fees | 150,390 | 0.5% | 116,048 | 0.4% | 102,504 | 0.3% | 99,494 | 0.3% | |
| Office | 143,641 | 0.5% | 131,780 | 0.4% | 195,571 | 0.6% | 189,827 | 0.6% | |
| Utilities | 85,980 | 0.3% | 128,300 | 0.4% | 125,211 | 0.4% | 128,967 | 0.4% | |
| Software | 32,463 | 0.1% | 109,872 | 0.4% | 91,315 | 0.3% | 88,633 | 0.3% | |
| Professional Fees | 41,539 | 0.1% | 191,697 | 0.6% | 234,615 | 0.7% | 241,653 | 0.7% | |
| Contributions | 3,200 | 0.0% | 7,000 | 0.0% | 5,600 | 0.0% | 5,436 | 0.0% | |
| Officer Life Insurance | 2,578 | 0.0% | 3,437 | 0.0% | 3,437 | 0.0% | 3,609 | 0.0% | |
| Miscellaneous | 11,975 | 0.0% | 2,507 | 0.0% | 4,303 | 0.0% | 4,177 | 0.0% | |
| Bank Charges | 2,350 | 0.0% | 5,139 | 0.0% | 5,201 | 0.0% | 5,048 | 0.0% | |
| Training | 5,059 | 0.0% | 1,836 | 0.0% | - | 0.0% | - | 0.0% | |
| Other | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% | |
| Other | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% | |
| Other | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% | |
| Other Expenses | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% | |
| Total Expense | 3,368,432 | 11.7% | 3,859,530 | 12.4% | 4,021,865 | 11.7% | 4,015,849 | 12.1% | 15.4% |
| Net Income from Operations | $ 822,311 | 2.9% | $ 975,624 | 3.1% | $ 390,706 | 1.1% | $ 501,083 | 1.5% | 7.9% |

Intercompany transactions have been eliminated, per the Accountant Audited Financials.

## 4.4 Current Year's Income Statement

The Interim Income Statement and Appraiser's Projected Income Statement are located below:

| *Accrual Basis* | Reviewed 9/30/2019 | | | Projected 3/31/2020 | | Adjustment Notes |
|---|---|---|---|---|---|---|
| Sales | $ 16,612,324 | 100% | | $ 33,224,648 | 100% | - |
| Cost of Goods Sold | 14,353,887 | 86.4% | | 28,707,774 | 86.4% | - |
| Gross Profit | 2,258,437 | 13.6% | | 4,516,874 | 13.6% | |
| Other Income | 29 | 0.0% | | 58 | 0.0% | - |
| Expenses | | | | | | |
| Officer Compensation | - | 0.0% | | 445,415 | 1.3% | =last year amount |
| Salaries & Wages | - | 0.0% | | 367,260 | 1.1% | =last year % |
| Repairs & Maintenance | - | 0.0% | | 33,597 | 0.1% | =last year % |
| Bad Debt | - | 0.0% | | - | 0.0% | - |
| Rents | - | 0.0% | | 475,880 | 1.4% | =last year + 3% |
| Taxes & Licenses | - | 0.0% | | 126,462 | 0.4% | =last year % |
| Interest | 68,397 | 0.4% | | 136,794 | 0.4% | - |
| Depreciation | - | 0.0% | | 179,023 | 0.5% | =last year amount |
| Advertising | - | 0.0% | | 34,296 | 0.1% | =last year % |
| Benefits / Pension Plan | - | 0.0% | | 93,729 | 0.3% | =last year % |
| Amortization | - | 0.0% | | - | 0.0% | - |
| Auto | - | 0.0% | | 285,266 | 0.9% | =last year % |
| Insurance | - | 0.0% | | 781,769 | 2.4% | =last year + 5% |
| Travel & Entertainment | - | 0.0% | | 289,514 | 0.9% | =last year % |
| Consulting Fees | - | 0.0% | | 99,494 | 0.3% | =last year % |
| Office | - | 0.0% | | 189,827 | 0.6% | =last year % |
| Utilities | - | 0.0% | | 128,967 | 0.4% | =last year + 3% |
| Software | - | 0.0% | | 88,633 | 0.3% | =last year % |
| Professional Fees | - | 0.0% | | 241,653 | 0.7% | =last year + 3% |
| Contributions | - | 0.0% | | 5,436 | 0.0% | =last year % |
| Officer Life Insurance | - | 0.0% | | 3,609 | 0.0% | =last year + 5% |
| Miscellaneous | - | 0.0% | | 4,177 | 0.0% | =last year % |
| Bank Charges | - | 0.0% | | 5,048 | 0.0% | =last year % |
| Training | - | 0.0% | | - | 0.0% | - |
| Other | - | 0.0% | | - | 0.0% | - |
| Other | - | 0.0% | | - | 0.0% | - |
| Other | - | 0.0% | | - | 0.0% | - |
| Other Expenses | 1,759,096 | 10.6% | *incl. above* | - | 0.0% | =last year amount |
| Total Expense | 1,827,493 | 11.0% | | 4,015,849 | 12.1% | |
| Net Income from Operations | $ 430,973 | 2.6% | | $ 501,083 | 1.5% | |

A breakdown of Other Expenses was not provided to the Appraiser. The Appraiser has estimated the annual expenses per the notes in the right hand column above.

Revenues

The Appraiser analyzes the 6 month reviewed income statement through September 30, 2019. The annualized sales (dividing the interim sales by 6 months and multiplying by 12 months) creates a decrease in sales of approximately -2.9%.

Because sales are not seasonal, the Appraiser found that annualizing sales provides a reasonable estimate of projected annual sales. The Supplemental Questionnaire also states that the annualized sales are accurate.

Cost of Goods Sold

The COGS margin in the interim period is 86.4%, which is reasonable based on the two year average COGS margin of 85.8%. Therefore, the Appraiser uses the interim COGS margin to estimate the projected margin.

Expenses

All expenses are estimated to be the same percentage of sales as the interim period except those with notes on the right hand column:

- = last year's amount
  - The expense is projected to equal the same as the prior year's expense
- = last year %
  - The expense as a percentage of sales is projected to equal the same as last year's percentage of sales
- = last year + X%
  - The expense is projected to equal the same as the prior year's expense plus X% growth.

Summary

Total annual expenses are 12.1% of sales, compared to 11.7% of sales in the prior year. The Appraiser finds this to be reasonable.

## 4.5 Financial Statement Adjustments

Often when analyzing the financial statements of a company, adjustments have to be made to the statements. Financial adjustments, frequently called "normalization adjustments," are intended to place the subject company's financial information on an economic basis. These adjustments are designed to provide better comparability to similar types of businesses.[28] The results of the ratio analysis in the following sections will be a major factor in calculating the value of Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. and assessing the appropriate risk involved.

"Normalization adjustments for such items as...non-business income and extraordinary and non-recurring events" must be made "to create results of operations that are realistic and representative of future operations."[29]

[28] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 143.
[29] Pratt, S, Fishman, J., Griffith, J, Hitchner, J., PPC's Guide to Business Valuations. Volume 1. (Forth Worth: Thomson Tax & Accounting, 2008), p. 5-31

Most often, the normalization adjustments that are made are categorized as 1) comparability adjustments, 2) non-operating/non-recurring adjustments, or 3) discretionary adjustments.[30] Some examples of such adjustments are owner's compensation, rent expense, interest expense, entertainment expense, automobile expense, and owner's perquisites.

The adjustments made to the financial statements will depend on the valuation approach and whether a controlling interest or a minority interest is being valued. Because a minority interest may not be able to effectuate a change in the company's financial position, it may be inappropriate to make such adjustments. For example, if the minority interest cannot set the compensation for the officers, an adjustment should probably not be made to the income stream.[31]

Typically when the control portion of a company is being appraised, adjustments to financial statements are made to reflect economic reality rather than simply using statements prepared for income tax or financial reporting requirements.[32]

In the case of Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc., a controlling interest in the company is being valued. Therefore, no control adjustments or discounts are necessary for a minority share. The following adjustments were considered:

### Officer's Compensation

Officer's compensation must be added back to the net income for the Company to realize the true cash flow to the owner. However, when calculating certain earnings streams and owner's compensation, the market salary for a manager that would replace the owner must be calculated and deducted in the adjustments.

As per Section 2.5 *Employees*, the Company is owned by the following:

| Owner Name | Hours | Responsibilities |
|---|---|---|
| Rob Belz | 40 | Controller |
| Stephen Dimeglio | 20 | Project Manager - BDSM |
| James Dvorak | 20 | Project Manager - DnB |
| Al LaBella | 40 | Sales Operations |

To estimate the EBITDA, a replacement cost for a general manager, must be adjusted for fair market salary. EBITDA assumes that an owner is not working at the location, and that a manager will replace the owner at a fair market salary.

To estimate the fair market replacement salary for the owner, the Appraiser estimates the market salary of a sales manager. The Appraiser notes a salary estimate from online data (https://money.usnews.com/careers/best-jobs/sales-manager/salary) for a sales manager is approximately $125,000 per year. To calculate EBITDA, the estimated market salary (along with 11% payroll taxes) is removed from the projected FYE 2020 net income (prior years are reduced by 3.0% to account for wage increases as per the second paragraph below). This will help calculate the EBITDA earnings stream, but

30 Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 143
31 Ibid, p. 143
32 Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. Guide to Business Valuations. (Fort Worth: Practitioners Publishing Company, 1999) Ninth Edition, Volume 1, p. 4-19, paragraph 404.4.

the market salary will be added back to the EBITDA to calculate Seller's Discretionary Earnings (or cash flow).

A hypothetical buyer would replace one of the current owners handling the operations of the business. The Appraiser assumes a hypothetical buyer would choose to take over Mr. LaBella's responsibilities at the Company and would require a replacement for the three other owners. The Appraiser notes a salary estimate from online data (https://www.glassdoor.com/Salaries/controller-salary-SRCH_KO0,10.htm) for a controller is approximately $100,000 per year. The Appraiser notes a salary estimate from online data (https://www.glassdoor.com/Salaries/construction-project-manager-salary-SRCH_KO0,28.htm) for a project manager is approximately $99,000 per year (as Mr. Dimeglio and Mr. Dvorak are stated to work 20 hours each, it is assumed one person could replace both of their responsibilities). The estimated salaries (along with 11% for payroll taxes) is subtracted from the Company's projected FYE 2020net income – prior years are reduced by 3.0% to account for wage increases as per the paragraph below.

The average of the median increases in the national average wage index according to the Social Security Department[33] from 2014 to 2017 was approximately 3.0%. This was the most recent data as of the Effective Date and is assumed to be the same for 2018 and/or 2019; accordingly, the Appraiser will decrease (and increase) the owner's compensation for previous (and future) years based on approximately 3.0%. Payroll taxes, FUCA and FICA are estimated to be 11.0% of payroll. These have been added back to the actual compensation, and reduced out of the market compensation.

### Rent Adjustment

The owner of the Company also owns the building and real estate that it rents from. If the tenant and the landlord have a relationship that gives the tenant a discount (often, the tenant [business] owns the property as well), then the business appraiser must take this non-arm's length relationship into account. Appraisers must assume that a hypothetical buyer will not benefit from the existing relationship between parties. Therefore, the actual rent paid by the Company is added back to the net income and the fair market rent must be subtracted, as calculated below.

As a real estate appraisal was not available to estimate the fair market rent, the Appraiser estimates the fair market rent based on comparable rents from Loopnet.com. Loopnet.com had three similar industrial spaces for lease in the Medford, NY area. The rental rates were $8.55, $8.65 and $9.85 per square foot. Based on this, the Appraiser estimates the fair market rent (NNN) per square foot to be $9.02.

According to the Business Valuation Questionnaire, the Company occupies 53,000 square feet. Based on this, the fair market rent would be approximately $478,000 for FYE 2020. Previous years are reduced by 3% to account for inflation and an increase in the Customer Price Index.

The comparable lease rates did not state whether they were on a NNN or gross basis. The Appraiser does not make any further adjustments for property taxes, insurance, and common area charges.

*The fair market value of the Company is dependent on the market rental rates of the real property owned by the Company, as found on Loopnet.com. The Appraiser makes an extraordinary assumption that the market rental rates are accurate based on the research stated. If the real property market rental rates were different, the fair market value of the subject Company could be different. The Appraiser reserves the right to update this report in event the fair market rent is determined to be different than estimated.*

[33] Social Security Online - https://www.ssa.gov/oact/cola/central.html

Below, the income statement summary and adjustments to the income are summarized.

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Sales | $ 28,828,055 | $ 31,192,721 | $ 34,229,937 | $ 33,224,648 |
| Cost of Sales | 24,637,312 | 26,357,569 | 29,817,374 | 28,707,774 |
| Gross Profit | 4,190,743 | 4,835,152 | 4,412,563 | 4,516,874 |
| Other Income | - | 2 | 8 | 58 |
| Total Expense | 3,368,432 | 3,859,530 | 4,021,865 | 4,015,849 |
| Net Income | 822,311 | 975,624 | 390,706 | 501,083 |
| Pretax Net Income | 822,311 | 975,624 | 390,706 | 501,083 |
| **Operating Adjustments** | | | | |
| Add: Officer's Compensation - Actual | 434,389 | 445,415 | 445,415 | 445,415 |
| Add: Officer's Est. Payroll Taxes | 47,783 | 48,996 | 48,996 | 48,996 |
| Less: Officer's Compensation - Market | (114,393) | (117,824) | (121,359) | (125,000) |
| Less: Officer's Estimated Payroll Taxes | (12,583) | (12,961) | (13,350) | (13,750) |
| Less: Replacement Salary - Rob Belz | (91,514) | (94,260) | (97,087) | (100,000) |
| Less: Replacement Salary (Stephen & James) | (90,599) | (93,317) | (96,117) | (99,000) |
| Less: Estimated Payroll Taxes | (20,032) | (20,633) | (21,252) | (21,890) |
| Add: Rent - Actual | 416,712 | 523,192 | 462,019 | 475,880 |
| Less: Rent - Fair Market | (437,438) | (450,561) | (464,078) | (478,000) |
| Other | - | - | - | - |
| Other | - | - | - | - |
| Other | - | - | - | - |
| Other | - | - | - | - |
| Total Adjustments | 132,325 | 228,047 | 143,187 | 132,650 |
| **Adjusted Pretax Net Income** | $ 954,636 | $ 1,203,671 | $ 533,893 | $ 633,734 |

As noted above, some of the financial adjustments were given to the Appraiser by third parties and the Appraiser assumes that the adjustments are reliable and accurate. The adjustments are based on discussions with the Client, Company owner or prospective buyer. The table below shows other types of income streams that will be used later in this valuation.

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| **Adjusted Pretax Net Income** | 954,636 | 1,203,671 | 533,893 | 633,734 |
| + Interest | 142,618 | 148,644 | 155,765 | 136,794 |
| **= EBIT** | 1,097,254 | 1,352,315 | 689,658 | 770,528 |
| % of sales | *3.8%* | *4.3%* | *2.0%* | *2.3%* |
| + Amortization | 4,104 | 2,052 | - | - |
| + Depreciation | 79,718 | 79,862 | 179,023 | 179,023 |
| **= EBITDA** | 1,181,076 | 1,434,229 | 868,681 | 949,551 |
| % of sales | *4.1%* | *4.6%* | *2.5%* | *2.9%* |
| + Market Owner's Compensation (inc. taxes) | 126,976 | 130,785 | 134,709 | 138,750 |
| **= Seller's Discretionary Earnings (SDE)** | $ 1,308,051 | $ 1,565,014 | $ 1,003,390 | $ 1,088,301 |
| % of sales | *4.5%* | *5.0%* | *2.9%* | *3.3%* |

## 4.6 Balance Sheet – Historical Unadjusted

The historical balance sheets along with the most recent balance sheet provided are spread out in the table below. The most recent balance sheet will be broken out in detail in Section 5.4 *Application of the Asset Approach.*

| *Accrual Basis* | 2016 Audited FYE 2017 | | 2017 Audited FYE 2018 | | 2018 Audited FYE 2019 | | Reviewed 9/30/2019 | | NAICS 332322 |
|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | |
| **Current Assets** | | | | | | | | | |
| Cash | $ 348,038 | 2.2% | $ 641,275 | 4.1% | $ 997,904 | 6.6% | 214,290 | 1.4% | |
| Accounts Receivable | 11,211,858 | 71.8% | 12,462,273 | 79.3% | 11,746,124 | 77.9% | 11,772,608 | 76.6% | |
| Inventory | 185,997 | 1.2% | 143,433 | 0.9% | 175,263 | 1.2% | 167,553 | 1.1% | |
| Other Current Assets | 3,459,493 | 22.1% | 2,012,265 | 12.8% | 1,719,261 | 11.4% | 2,741,944 | 17.8% | |
| Total Current Assets | 15,205,386 | 97.3% | 15,259,246 | 97.1% | 14,638,552 | 97.0% | 14,896,395 | 96.9% | 67.9% |
| **Fixed Assets** | | | | | | | | | |
| Building and Other | 337,256 | 2.2% | 382,794 | 2.4% | 374,266 | 2.5% | | 0.0% | |
| Less: Accum. Dep. | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Other Assets | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Other Assets | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Total Fixed Assets | 337,256 | 2.2% | 382,794 | 2.4% | 374,266 | 2.5% | 400,061 | 2.6% | 24.6% |
| **Other Assets** | | | | | | | | | |
| Amortizable Assets | 3,073 | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Less: Accum. Amort. | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Deposits | 74,291 | 0.5% | 74,291 | 0.5% | 74,291 | 0.5% | | 0.0% | |
| Other Assets | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Total Other Assets | 77,364 | 0.5% | 74,291 | 0.5% | 74,291 | 0.5% | 74,291 | 0.5% | 7.5% |
| Total Assets | $15,620,006 | 100% | $ 15,716,331 | 100% | $ 15,087,109 | 100.0% | $ 15,370,747 | 100.0% | 100.0% |
| **LIABILITIES AND EQUITY** | | | | | | | | | |
| **Current Liabilities** | | | | | | | | | |
| Accounts Payable | $ 3,011,264 | 19.3% | $ 3,187,298 | 20.3% | $ 2,931,455 | 19.4% | | 0.0% | |
| Short Term Loans | 2,863,768 | 18.3% | 2,595,639 | 16.5% | 2,006,052 | 13.3% | | 0.0% | |
| Billings in Excess of Costs | 16,992 | 0.1% | 13,735 | 0.1% | 48,675 | 0.3% | | 0.0% | |
| Income Taxes | 283,525 | 1.8% | 281,559 | 1.8% | 281,559 | 1.9% | | 0.0% | |
| Total Current Liabilities | 6,175,549 | 39.5% | 6,078,231 | 38.7% | 5,267,741 | 34.9% | 5,316,637 | 34.6% | 38.7% |
| **Long Term Liabilities** | | | | | | | | | |
| Long Term Loans | 62,932 | 0.4% | 150,062 | 1.0% | 221,206 | 1.5% | | 0.0% | |
| Other Loans | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Total Long-term Liabilities | 62,932 | 0.4% | 150,062 | 1.0% | 221,206 | 1.5% | 209,196 | 1.4% | 10.9% |
| Total Liabilities | 6,238,481 | 39.9% | 6,228,293 | 39.6% | 5,488,947 | 36.4% | 5,525,833 | 36.0% | 52.1% |
| **Equity** | | | | | | | | | |
| Capital Stock / APICapital | 163,000 | 1.0% | 163,000 | 1.0% | 163,000 | 1.1% | | 0.0% | |
| Retained Earnings | 9,218,525 | 59.0% | 9,325,038 | 59.3% | 9,435,162 | 62.5% | | 0.0% | |
| Adj. to Equity/Treasury | - | 0.0% | - | 0.0% | - | 0.0% | | 0.0% | |
| Total Equity | 9,381,525 | 60.1% | 9,488,038 | 60.4% | 9,598,162 | 63.6% | 9,844,914 | 64.0% | 47.9% |
| Total Liabilities and Equity | $15,620,006 | 100% | $ 15,716,331 | 100% | $ 15,087,109 | 100% | $ 15,370,747 | 100% | 100.0% |

## 4.7 Industry Ratio Analysis

The following sections of the report include trend and ratio analysis of the subject company. Also included is the company forecast, including operational expectations. Common-size financial statements will be used to compare the subject company industry averages, obtained from the Risk Management Association (RMA) Annual Statement Studies Valuation Edition (2018-2019), distributed by ValuSource Software), a source of industry data commonly used by business appraisers, bankers, and others that perform comparative financial analysis.

The license agreement requires that the Appraiser notify the user of the report that (i) the data was compiled from a sample not necessarily statistically representative and that reliance thereon should be limited accordingly; (ii) the data has been obtained from or is based upon sources believed by RMA to be reliable, however, the data is provided without warranty of any kind and RMA makes no representations or warranties, express or implied, to licensee or any other person or entity as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any of the data; and (iii) the data is provided without warranty on the understanding that any person or entity that acts upon it or otherwise changes position in reliance thereon does so entirely at such person's or entity's own risk. RMA Annual Statement Studies and the information contained therein are copyrighted; and users of this data shall not, without specific prior written approval by RMA, refer to RMA or its Annual Statement Studies in any other manner, or imply any endorsement by RMA of the product in which the data is used.

All industry data used in this section is assumed to be prepared on a comparable accounting basis to the Company. Furthermore, the Appraiser makes an extraordinary assumption that if the industry data is prepared on a different accounting basis than the Company, it will not have a material impact on the analysis conducted in this report.

The excerpt from the 2019-2020 RMA Data for NAICS Code 332322 (Sheet Metal Work Manufacturing) is shown in the table on the following page. The data presented in the table on the following page (from the National geographic region) shows data from 68 statements ranging between $25MM & Over in annual revenues (as the narrower sales range data contained 30 or more statements, which is deemed a reliable number of statements as per the RMA.)

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## General Information

| | |
|---|---|
| Data Source | RMA Annual Statement Studies™ 2019-2020 |
| Industry Sector | Manufacturing |
| Industry Title | Sheet Metal Work Manufacturing |
| Industry Code | 332322 |
| Region | National |
| Industry Subset | Sales 25MM & Over |

## Current Annual Data — Year Ending 3/31/19

| Assets | $ | % |
|---|---|---|
| Cash & Equivalents | 3,636,246 | 9.2% |
| Trade Receivables (Net) | 11,541,128 | 29.2% |
| Inventory | 10,315,871 | 26.1% |
| All Other Current | 1,343,830 | 3.4% |
| Total Current | 26,837,076 | 67.9% |
| Fixed Assets (Net) | 9,723,005 | 24.6% |
| Intangibles (Net) | 1,541,452 | 3.9% |
| All Other Non-Current | 1,422,879 | 3.6% |
| Total | 39,524,412 | 100.0% |

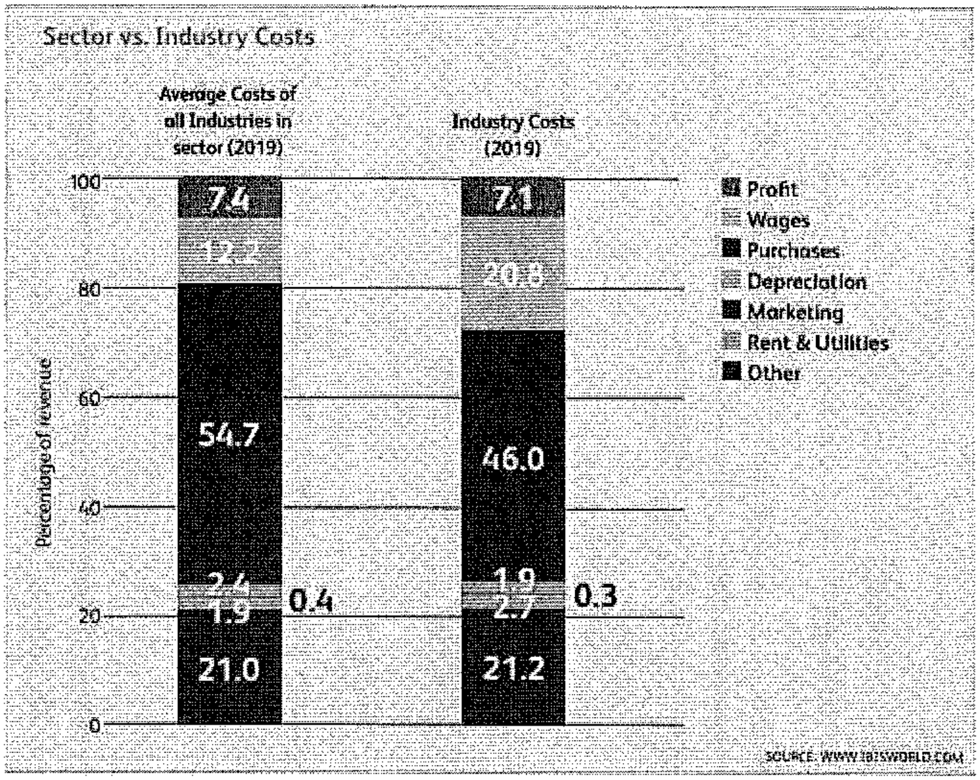
| Liabilities & Net Worth | $ | % |
|---|---|---|
| Notes Payable-Short Term | 4,189,588 | 10.6% |
| Cur.Mat.-L/T/D | 1,264,781 | 3.2% |
| Trade Payables | 5,731,040 | 14.5% |
| Income Taxes Payable | 39,524 | 0.1% |
| All Other Current | 4,031,490 | 10.2% |
| Total Current | 15,295,947 | 38.7% |
| Long-Term Debt | 4,308,161 | 10.9% |
| Deferred Taxes | 237,146 | 0.6% |
| All Other Non-Current | 750,964 | 1.9% |
| Net Worth | 18,932,193 | 47.9% |
| Total Liabilites & Net Worth | 39,524,412 | 100.0% |

| Income Statement | $ | % |
|---|---|---|
| Net Sales | 76,117,985 | 100.0% |
| Cost of Sales | 58,382,495 | 76.7% |
| Gross Profit | 17,735,491 | 23.3% |
| Operating Expenses | 11,722,170 | 15.4% |
| Operating Profit | 5,937,203 | 7.8% |
| All Other Expenses (Net) | 456,708 | 0.6% |
| Profit Before Taxes | 5,480,495 | 7.2% |

| Analysis | |
|---|---|
| Profit Before Taxes / Tangible Net Worth | 29.0 |
| Profit Before Taxes / Assets | 11.2 |
| Current Ratio | 1.8 |
| Quick Ratio | 0.9 |
| Debt / Worth | 1.0 |
| Sales / Assets | 2.3 |
| Z Score - Public Company | 4.0 |
| Z Score - Closely Held Company | 3.4 |
| Z Score - Small Business Company | 5.4 |

| Statement Counts | |
|---|---|
| Unqualified | 12 |
| Reviewed | 16 |
| Compiled | 4 |
| Tax Returns | 3 |
| Other | 33 |
| Total | 68 |

In addition to comparing the Company to the RMA Industry Standards, the Appraiser will also use the cost structure from a chart extracted from Section 3.2.1 *Characteristics of the Industry* - originally from IBISWorld, Inc.




Revenues (100%) – Purchases (46.0%) = Gross Profit (54.0%)
Profit (7.1%) + Depreciation (1.9%) = EBITD (9.0%)

Typical of a closely held business, the balance sheet is not as important as the profitability[34], so profitability ratios are analyzed below. However, as the purpose of this assignment is to determine the value of stock not assets, the appraiser found it relevant to also analyze the liquidity and turnover ratios of the Company.

### 4.7.1 Profitability Ratios

The following shows the summary of income statements for the last three years, common sized. This makes it easy to compare changes year to year.

[34] Gary Trugman. Essentials of Valuating a Closely Held Business, First Edition (New York: American Institute of Certified Public Accountants, Inc., 2009), p.61.

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of Sales | 85.5% | 84.5% | 87.1% | 86.4% |
| Gross Profit | 14.5% | 15.5% | 12.9% | 13.6% |
| Other Income | 0.0% | 0.0% | 0.0% | 0.0% |
| Total Expense | 11.7% | 12.4% | 11.7% | 12.1% |
| Net Income | 2.9% | 3.1% | 1.1% | 1.5% |
| | | | | |
| Company EBIT | 3.8% | 4.3% | 2.0% | 2.3% |
| Company EBITD | 4.1% | 4.6% | 2.5% | 2.9% |

*From Section 4.5 Financial Statement Adjustments*

The following chart illustrates common ratios used to compare the Company's income statement to the industry.

| PROFITABILITY RATIOS: | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Company EBIT | 3.8% | 4.3% | 2.0% | 2.3% |
| Company EBITD | 4.1% | 4.6% | 2.5% | 2.9% |
| Company Gross Profit | 14.5% | 15.5% | 12.9% | 13.6% |

| PROFITABILITY RATIOS: | | | Industry Average | Company Average | Company Median | Result |
|---|---|---|---|---|---|---|
| RMA Operating Profit* | vs | EBIT | 7.9% | 3.1% | 3.1% | Weaker |
| IBISWorld Profit** | vs | EBITD | 9.0% | 3.5% | 3.5% | Weaker |
| RMA Gross Profit | vs | Gross Profit | 23.3% | 14.1% | 14.1% | N/A |
| IBISWorld Gross Profit | vs | Gross Profit | 54.0% | 14.1% | 14.1% | N/A |

** Gross profit minus operating expenses*

*** EBIT + Depreciation*

**Operating Profit Margin = Net Income / Sales**

This ratio measures the percentage of income to sales.

*Analysis:*

The Company's average and median operating profit margins are weaker than the RMA averages and weaker than the IBISWorld average. This shows that the Company is weaker than other companies within the same industry in terms of net profitability.

**Gross Profit Margin = (Sales - Cost of Goods Sold) / Sales**

This ratio measures the gross profit as a percentage of sales.

*Analysis:*

The Company classified certain expenses under Cost of Goods Sold which may different from what RMA and IBISWorld classified as purchases. Therefore, the Appraiser feels that this comparison is not an accurate indicator of financial risk or strength.

### 4.7.2 Liquidity Ratios

The following charts illustrate common ratios used to compare the Company's liquidity ratios to the industry averages from the RMA data.

| LIQUIDITY RATIOS: | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Current Ratio | 2.5 | 2.5 | 2.8 | 2.7 |
| Quick Ratio | 2.4 | 2.5 | 2.7 | 2.6 |

| LIQUIDITY RATIOS: | Industry Average | Company Average | Company Median | Result |
|---|---|---|---|---|
| Current Ratio | 1.8 | 2.6 | 2.6 | Stronger |
| Quick Ratio | 0.9 | 2.6 | 2.6 | Stronger |

**Current Ratio = Current Assets / Current Liabilities**
The current ratio measures the margin of the safety that management maintains to allow for the inevitable unevenness in the flow of funds through the current asset and current liability accounts. A company's liquidity is essential to its good credit, its ability to grow with its own finds, and its ability to pay dividends to its owners.[35]

**Quick Ratio = (Cash + Marketable Sec. + Accounts Receivable) / Current Liabilities**
The quick ratio is a measure of the extent to which liquid resources are available to meet current obligations. This ratio tends to be a better measured of the company's short term liquidity, particularly if cash needs to be generated quickly to pay bills.[36]

*Analysis:* The Company's current ratio is stronger than the industry average and the quick ratio is stronger than the industry average. *However, this will change post transaction as a hypothetical Buyer would obtain financing and increase CPTLD.*

### 4.7.3 Turnover Ratios
The following charts illustrate common ratios used to compare the Company's turnover ratios to the industry averages from the RMA data.

| TURNOVER RATIOS: | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| COGS / Inventory | 132.5 | 183.8 | 170.1 | 171.3 |
| Sales / Receivables | 2.6 | 2.5 | 2.9 | 3.0 |
| COGS / Payable | 8.2 | 8.3 | 10.2 | 9.4 |

| TURNOVER RATIOS: | Industry Average | Company Average | Company Median | Result |
|---|---|---|---|---|
| COGS / Inventory | 6.9 | 164.4 | 170.7 | Stronger |
| Days Turnover | *52.9* | *2.2* | *2.1* | |
| Sales / Receivable | 8.5 | 2.8 | 2.7 | Weaker |
| Days Turnover | *42.9* | *132.6* | *133.1* | |
| COGS / Payable | 12.9 | 9.0 | 8.8 | Weaker |
| Days Turnover | *28.3* | *40.5* | *41.3* | |

[35] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 128
[36] Ibid., p. 128

**COGS / Inventory = Cost of Goods Sold / Ending Inventory**
Average inventory may be used instead of the ending inventory level to minimize seasonal factors (if such factors exist – which doesn't apply to the Company). A low turnover implies poor sales and, therefore, excess inventory. A high ratio implies either strong sales or ineffective buying. High inventory levels are unhealthy because they represent an investment with a rate of return of zero. It also opens the company up to trouble should prices begin to fall.

*Analysis:*
The Company turns its inventory every 2.2 days on average, while the industry average is 52.9 days. This is reasonable based on the inventory type.

**Sales / Receivable = Annual Sales / Ending Accounts Receivable**
This ratio measures the number of times the receivables turnover in a year. By maintaining accounts receivable, firms are indirectly extending interest-free loans to their clients. A high ratio implies either that a company operates on a cash basis or that its extension of credit and collection of accounts receivable is efficient. A low ratio implies the company should re-assess its credit policies in order to ensure the timely collection of imparted credit that is not earning interest for the firm.

*Analysis:*
The Company turns its receivables every 132.6 days on average, while the industry average is 42.9 days. The aging accounts receivable reports will be analyzed in Section 5.4.

**COGS / Payable = Cost of Goods Sold / Ending Accounts Payable**
The accounts payable turnover ratio indicates how many times a company pays off its suppliers during an accounting period. It measures how a company manages paying its own bills. A higher ratio is generally more favorable as payables are being paid more quickly.

*Analysis:*
The Company turns its payables every 40.5 days on average, while the industry average is 28.3 days. This is reasonable based on the vendor terms.

## 4.8 Summary, Conclusions and Implications for Value

Overall, Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc.'s net profitability is weaker than the industry average. The Company's turnover ratios are weaker than the industry averages. The financial statement analysis of the Company indicates the risk associated with Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. is greater than the risk associated with the industry average.

## 4.9 Financial Forecast

According to Internal Revenue Service Revenue Ruling 59-60, "Valuation of securities is, in essence, a prophecy as to the future and must be based on facts available at the required date of appraisal."[37] The only time history can be used is if it represents what is expected to happen in the future.[38] However, most lenders, as well as small business buyers, depend on the historical performance to calculate the future financial performance and ability to service debt. Additionally, the Small Business Administration has

[37] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 3. Approach to Valuation, paragraph .03.
[38] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 412.

previously relied on weighted average of historical figures when developing certain internal valuation methodologies. Accordingly the Appraiser uses a weighted average on historical financials to determine the weighted sales and income figures that he will apply a growth rate to.

If the company has been showing losses, the projections should go out far enough to allow the company to return to a level of normal sustainable profitability. The same is true if the company has been making large profits. Go out far enough to reflect the normal conditions for the company. Stabilization is the goal to be achieved in the projection period.[39]

The Appraiser prepared the income forecast using the weighted historical financial statements as a base. Later on in this report, the future earnings stream and sales which are derived from the following projections will be used in various income and market approach valuation methods.

**Historical Sales and Estimated Weighting**

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| Sales | $ 28,828,055 | $ 31,192,721 | $ 34,229,937 | $ 33,224,648 |
| **Adjusted Pretax Net Income** | 954,636 | 1,203,671 | 533,893 | 633,734 |
| **Earnings Before Interest & Taxes (EBIT)** | 1,097,254 | 1,352,315 | 689,658 | 770,528 |
| **EBIT plus Depr. & Amort. (EBITDA)** | 1,181,076 | 1,434,229 | 868,681 | 949,551 |
| **Seller's Discretionary Earnings (SDE)** | 1,308,051 | 1,565,014 | 1,003,390 | 1,088,301 |
| **Weight** | **0%** | **0%** | **70%** | **30%** |

Weighted Historical Financials are calculated by weighting each quantity by determining the relative importance of the respective quantity on the total average. This method is preferred if any one or more years in the past are a better indicator of performance than the most recent year. The Appraiser assigned 0% weight to FYE 2017 and FYE 2018, as the FYE 2017 financials are over 36 months old and the sales and earnings have fluctuated since FYE 2018. Because the FYE 2019 financials are based on audited financials (which are considered a reliable source of information and are based on a full 12 months of actual operations) the Appraiser applied 70% weight to the FYE 2019 financials. The FYE 2020 projections are based on 6 months of accountant reviewed financials and reflect the Company's most recent performance. Accordingly, the Appraiser assigned 30% of the weight to the FYE 2020 financials.

The revenue and earnings projections for next year are located below:

[39] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 292.

**Weighted Financials / Projections**

| | | |
|---|---|---|
| Weighted Sales | $ | 33,928,350 |
| Sustainable Growth Rate | | 2.5% |
| **Next Year's Projected Sales** | | 34,776,559 |
| Weighted EBIT | $ | 713,919 |
| Sustainable Growth Rate | | 2.5% |
| **Next Year's Projected EBIT** | | 731,767 |
| Weighted EBITDA | $ | 892,942 |
| Sustainable Growth Rate | | 2.5% |
| **Next Year's Projected EBITDA** | | 915,265 |
| Weighted SDE | $ | 1,028,863 |
| Sustainable Growth Rate | | 2.5% |
| **Next Year's Projected SDE** | | 1,054,585 |

The Appraiser feels that new management, along with the positive economic outlook discussed in Section 3.1.3 *Economic Outlook* (2.3% in 2019, 1.7% in 2020, and 2.0% in 2021) should help revenues and earnings grow in a steady fashion. Additionally, due to the expected increase in revenues in the industry of about 1.2% per year for the next 5 years, as per the discussions in Section 3.2.2 *Industry Outlook*, **the Appraiser estimates that sales growth is likely to continue at a steady growth rate of about 2.5%.** This forecast takes into consideration all of the additional factors analyzed in the Section 4 *Financial Analysis of the Subject Company.*

The economic growth rates discussed above refer to real GDP growth, which does not include the inflation rate. The Appraiser notes that businesses typically increase their prices to parallel the rate of inflation, resulting in revenue growth that exceeds "real" growth. Although the economic outlook used in this analysis does not consider inflation, the Appraiser uses historical and projected nominal GDP growth (real growth plus inflation) as a sanity check and a justification of the Company's estimated long-term growth rate:

*A Consensus View: Q&A Guide to Financial Valuation* examines nominal GDP in various periods starting in 1926 and 1963 as they are the starting points for the Duff & Phelps CRSP data and Risk Premium Report data: Using all the historical data periods, the range is approximately 6% to 7%, with the longer periods trending to approximately 6%. For forecasted growth rates, the range is approximately 5% to 6%, with a trend slightly less than 5%. Using both the historical data as well as the forecasted data, over the long term, broad economic measures have grown by about 5% to 6%.[40]

As such, the Appraiser is able to deem a long-term growth rate up to 5% reasonable, given it is supported by the other factors discussed in this report.

[40] Jay E. Fishman, James R. Hitchner, and Shannon P. Pratt, A Consensus View: Q&A Guide to Financial Valuation. (New Jersey: Valuation Products and Services, LLC, 2016), p. 37.

# 5. VALUATION OF THE SUBJECT COMPANY

The standard of value used to appraise Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. will be Fair Market Value. According to IRS *Revenue Ruling 59-60*, fair market value is defined as, "the price at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy, and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts."[41]

The equity being valued for Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. will be valued on what is commonly referred to as an "ongoing basis." This means that it is assumed that the company will continue in business and will be valued as an operating company. An operating company typically has a higher value than the sum of its individual parts looked at separately.

*Revenue Ruling 59-60* states that all relevant factors should be taken into consideration, including the following:[42]

1) The nature of the business and the history of the enterprise from its inception.
2) The economic outlook, in general, and the condition and outlook of the specific industry, in particular.
3) The book value of stock and the financial condition of the business.
4) The earnings capacity of the company.
5) The dividend-paying capacity.
6) Whether or not the enterprise has goodwill or other intangible value.
7) Sales of stock and the size of the block of stock to be valued.
8) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market either on an exchange or over the counter.

These eight factors, along with one additional factor, are also stated in Standard Five of the Institute of Business Appraiser's Business Appraisal Standards, as mentioned in Section 1.10 *Premise of Value.*

The *Uniform Standards of Professional Appraisal Practice* (USPAP) are the generally accepted standards for professional appraisal practice in North America. USPAP contains standards for all types of appraisal services. *Uniform Standards of Professional Appraisal* (USPAP) require business appraisers to "include in the analyses, when relevant, data regarding" the same eight factors referenced above from IRS Revenue Ruling 59-60.

Three primary approaches used to value businesses can be derived from *Revenue Ruling 59-60*:

1) Asset Approach
2) Market Approach
3) Income Approach

Each method is explained below in more detail.

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[41] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 2. Background and Definitions, paragraph .02.
[42] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph .01.

## 5.1 Asset Approach

The asset- based approach is also commonly known as the "cost approach" or the "replacement-cost approach." In this approach, each component of the business is valued separately. This also includes the liabilities. Then asset values are totaled, and the total of the liabilities is subtracted to derive the total value of the enterprise.[43]

However, if you value only the tangible assets and liabilities, this approach is considered to be a "floor value" for an enterprise being valued as a going concern.[44] Thus, to get the value of the entire company, the value of intangibles must be added to the value of the tangibles, before subtracting out liabilities.

The three main valuation approaches in the asset-based approach are:

1) Adjusted Book Value (Net Asset Value)
2) Liquidation Value Method
3) Excess Earnings Method

In the adjusted book value method, all of the assets and liabilities are adjusted to reflect their fair market value. The fair market value of the subject company's equity will be the fair market value of the assets less the fair market value of their liabilities. The adjusted book value method is primarily used in the appraisal of asset-intensive businesses in the valuation of a controlling interest.[45] This method is usually used to value businesses...such as real estate holding companies, manufacturing companies, and other asset intensive companies.[46] [The adjusted book value method] is generally not used to value service businesses and distribution businesses that have few tangible assets, nor is it usually used to appraise intangible assets or minority interests of stockholders who have no control over the sale of the assets.[47]

The liquidation value is the net amount expected to be left over after all assets are sold off and the proceeds are used to satisfy existing liabilities.[48] The liquidation can either be an orderly liquidation, or a forced liquidation; the difference between the two being the given time to find the purchaser of the assets. The most obvious use of the liquidation method is when an actual liquidation of the business is contemplated. The liquidation methodology should also be considered when the highest and best use of the property is to liquidate, as opposed to valuing the entity as a going concern, if the interest being valued has the right to liquidate.[49]

In order to determine the value of the unidentifiable intangibles (i.e.: goodwill), the Excess Earnings Method is often used. This is a hybrid between the adjusted book value method (which derives the value of tangibles) and the income based approach (which derives the value of intangibles). The excess earnings are derived by forecasting the normalized annual net income (after-tax or pretax) for the entity in the same manner as in the other income approach methods. Then, a reasonable rate of return on the net

[43] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 257.
[44] Ibid., p. 257.
[45] Ibid., p. 259.
[46] Ibid., p. 258.
[47] Gary Trugman. Essentials of Valuing a Closely Held Business, First Edition (New York: American Institute of Certified Public Accountants, Inc., 2009), p. 20.
[48] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 276.
[49] Ibid., p. 276.

tangible assets is subtracted from the normalized net income to determine the excess earnings. These earnings are then capitalized to arrive at the intangible value of the enterprise.[50]

Gary Trugman states, "The excess earnings method should be used only if no better method is available to determine the value of the intangibles. Frequently, the enterprise can be valued with a different method, possibly from an income approach that calculates the tangible and intangible value."[51]

## 5.2 Market Approach

The market approach is probably the most fundamental approach in a fair market value appraisal. Since fair market value is supposed to come from the "market," it seems natural that this approach should be greatly emphasized. The application of this method can, at times, be the most difficult approach to use in a business appraisal.[52]

The market approach emphasizes the principle of substitution; given alternative investments, an individual would have gravitation towards the lowest price in the market, assuming that all attributes are the same.

The market approach is the most direct approach for establishing the fair market value of a business.[53] The methods that are used most often under this approach are (1) the guideline public company method, and (2) the Guideline Merger and Acquisition Method (transaction method).

The **Guideline Public Company Method (GPCM)** of appraisals is based on the premise that pricing multiples (a relationship between the price of a publicly traded stock and some other variables, such as earnings, sales, book value, etc.) of publicly traded companies can be used as a tool to be applied in valuing the closely held appraisal subject.[54]

*Revenue Ruling 59-60* tells us to consider the "market price of stocks of corporations engaged in the same or similar line of business, having their stocks actively traded in a free and open market either on an exchange or over the counter."[55] Appraisals of larger closely held companies can be performed using the GPCM, since larger companies frequently take on many of the characteristics of their publicly traded counterparts. Therefore, comparing larger closely held companies with publicly traded guideline companies is an effective method of valuation.[56]

In the **Guideline Merger and Acquisition Method (Transaction Data Method)**, transaction data is used in a manner similar to that of the GPCM, but instead of selecting publicly traded companies, actual transactions of privately held small businesses that are similar to the subject being appraised, are used to determine pricing. Acquisition methods are those that value a company based on transactions involving a large portion of the company or its entirety. Since most closely held transactions involve entire

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[50] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 310.
[51] Gary Trugman. Essentials of Valuing a Closely Held Business, First Edition (New York: American Institute of Certified Public Accountants, Inc., 2009), p. 23.
[52] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 157.
[53] Ibid., p. 158.
[54] Ibid., p. 201.
[55] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph .02(h).
[56] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 201.

companies, this method is a logical application of the market approach. Market transactions are assumed to be between informed buyers and sellers, a good representation of fair market value occurs if there are enough transactions to be statistically meaningful.[57]

Although generally used when valuing small to medium sized closely held businesses, the Transaction Data Method can be applied by using public company or private company data. If public companies are used to develop the multiples, the results are control, marketable values. If private companies are used instead, the results are control, non-marketable value.[58]

## 5.3 Income Approach

*Revenue Ruling 59-60* suggests "Earnings may be the most important criterion of value in some cases..."[59] Earnings capacity or income, can be described in a number of different ways (i.e.: net income after tax, cash flow, debt-free income, etc.). These income streams, also known as benefit streams, are converted into estimates of the value of the appraisal subject. The two processes that are used in the income approach are known as capitalization and discounting.[60]

1) Capitalization – A single-period valuation model that converts a benefits stream into value by dividing the benefits stream by a rate of return that is adjusted for growth. A common variation of this theme is the reciprocal or the market multiple price/earnings, which would be earnings/price. An earnings/price ratio is a capitalization rate.[61]
2) Discounting – A multiple-period valuation method that converts a future series of benefit streams into value by discounting them to present value at a rate of return that reflects the risk inherent in the benefits stream.[62]

A capitalization model uses a current benefit stream and assumes that the particular stream of income will be received into perpetuity. A discounting model uses a forecast benefit stream and then discounts that stream back into present value.[63] The capitalization method should be used when the future benefit stream will be constant. The discounting model should be used when the future income stream is expected to vary. There is a significant relationship between the capitalization rate and discount rate. The *Capitalization Rate* is the *Discount Rate* minus the *Growth Rate*. Alternatively, the *Discount Rate* is the *Capitalization Rate* plus the *Growth Rate*.

The fundamental theory behind the income approach to valuing a business interest is that *the value of an investment is equal to the sum of the present values of the future benefits it is expected to produce for the owner of the interest.*[64]

[57] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 253-254.
[58] Ibid., p. 221.
[59] Internal Revenue Service, *Revenue Ruling 59-60*, Sec. 5. Weight to Be Accorded Various Factors, paragraph. (a).
[60] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 281.
[61] Ibid., p. 281.
[62] Ibid., p. 281.
[63] Ibid., p. 282.
[64] Ibid., p. 282.

## 5.4 Application of the Asset Approach

As per the discussion in Section 5.1 *Asset Approach*, [the adjusted book value method] is generally not used to value service businesses and distribution businesses that have few tangible assets, nor is it usually used to appraise intangible assets or minority interests of stockholders who have no control over the sale of the assets. [65]

The Adjusted Book Value Method will be shown only to estimate the value of identifiable assets. A *Certified Machinery and Equipment Appraiser (CMEA)* or other certified equipment appraiser should be engaged for actual fair market values of furniture, fixtures and equipment (FF&E).

The Book Value of a Company is calculated by subtracting its liabilities from its assets. The resulting figure is the book value, or shareholders' equity. This figure, however, is purely an accounting convention, and may have little or no relation to the actual adjusted net worth of the business. Book value is affected by numerous matters, including: inventory costing methods used, depreciation and amortization, accounting for income taxes, and the existence and amortization of goodwill and other intangible assets.[66] In some instances, the book value is a fair proxy for fair market value, that is, adjusted value, for machinery and equipment. Equipment is turned over on a regular basis and depreciation is based on economic life.[67] "Net book value" is defined as an asset's original price minus depreciation and amortization.[68]

Unless otherwise indicated, inventory (if applicable) is based on its book value as per the most recent balance sheet. **The Appraiser has not separately valued the inventory.** The Appraiser has not been made aware of any off-balance sheet assets or liabilities, unless discussed below. The Company's capital structure may include short and long term debt.

[65] Gary Trugman. Essentials of Valuing a Closely Held Business, First Edition (New York: American Institute of Certified Public Accountants, Inc., 2009), p. 20.
[66] Hawkins, George B., Paschall, Michael A., CCH Business Valuation Guide. Volume 1. (Chicago: CCH Incorporated, 2007), p. 2011
[67] Feder, Robert D., Valuation Strategies in Divorce. Third Edition. (Wiley Law Publications, 1993), p. 129
[68] U.S. Small Business Administration, Standard Operating Procedure (SOP) 50 10 5(K), p. 194

Adjusted Book Value Method

| *Accrual Basis* | Reviewed 9/30/2019 | Operating Yes/No | Adjusted Book Value | Included in Value | Included in Final Adj. Book Value | Ref. # |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| **Current Assets** | | | | | | |
| Cash and Equivalent | $ 214,290 | Yes | $ 214,290 | Yes | $ 214,290 | |
| Accounts Receivable | 11,772,608 | Partial | 10,999,968 | Yes | 10,999,968 | *1* |
| Inventory | 167,553 | Yes | 167,553 | Yes | 167,553 | |
| Costs & Earnings in Excess of Billings | 2,723,897 | Yes | 2,723,897 | Yes | 2,723,897 | |
| Prepaid Exp. & Misc. Receivables | 18,047 | Yes | 18,047 | Yes | 18,047 | |
| Total Current Assets | 14,896,395 | | 14,123,755 | | 14,123,755 | |
| **Fixed Assets*** | | | | | | |
| Furniture, Equipment & Fixtures | 400,061 | Appraised | - | | - | *2* |
| Vehicles | - | | 286,100 | Yes | 286,100 | *2* |
| Machinery and Equipment | - | | 1,338,920 | Yes | 1,338,920 | *2* |
| Less: Accum. Depreciation | - | | - | | - | |
| Building/Land | - | | - | | - | |
| Less: Accum. Depreciation (Building Only) | - | | - | | - | |
| Total Fixed Assets | 400,061 | | 1,625,020 | | 1,625,020 | |
| **Other Assets**** | | | | | | |
| Amortizable Assets | - | | - | | - | |
| Less: Accum. Amortization | - | | - | | - | |
| Other Assets | - | | - | | - | |
| Other Assets | - | | - | | - | |
| Deposits | 74,291 | Yes | 74,291 | Yes | 74,291 | |
| Total Other Assets | 74,291 | | 74,291 | | 74,291 | |
| Total Assets | $ 15,370,747 | | $ 15,823,066 | | $ 15,823,066 | |
| **LIABILITIES AND EQUITY** | | | | | | |
| **Current Liabilities** | | | | | | |
| Trade Accounts Payables | $ 3,051,307 | Yes | $ 3,051,307 | Yes | $ 3,051,307 | |
| Line of Credit - Bank | 1,795,000 | Yes | 1,795,000 | Yes | 1,795,000 | |
| Current Portion of LTD | 76,711 | Yes | 76,711 | Yes | 76,711 | |
| Income Taxes | 281,559 | Yes | 281,559 | Yes | 281,559 | |
| Billings In Excess of Costs | 112,060 | Yes | 112,060 | Yes | 112,060 | |
| Total Current Liabilities | 5,316,637 | | 5,316,637 | | 5,316,637 | |
| **Long Term Liabilities** | | | | | | |
| Long Term Loan | 209,196 | Yes | 209,196 | Yes | 209,196 | |
| Other Liabilities | - | | - | | - | |
| Other Liabilities | - | | - | | - | |
| Commercial Real Estate Loan | - | | - | | - | |
| Total Long-term Debt | 209,196 | | 209,196 | | 209,196 | |
| Total Liabilities | 5,525,833 | | 5,525,833 | | 5,525,833 | |
| **Equity** | | | | | | |
| Capital Stock / APICapital | 163,000 | | | | - | |
| Retained Earnings | 9,681,914 | | | | - | |
| Adj. to Equity/Treasury | - | | | | - | |
| Total Equity | 9,844,914 | Adjusted | 10,297,233 | Adjusted | 10,297,233 | |
| Total Liabilities and Equity | $ 15,370,747 | | $ 15,823,066 | | | |
| **Indicated Value (Rounded)** | | | | | **$10,297,000** | |

* All fixed assets (unless otherwise noted on the next page) are business operating assets and are included at net book value.
** When adjusting assets and liabilities to appraised value, unidentifiable intangible assets and their associated amortization should be removed[69]. Intangible assets include items such as goodwill, loan costs, organizational costs, franchise fees, etc.

[69] Pratt, S, Fishman, J., Griffith, J, Hitchner, J., PPC's Guide to Business Valuations. Volume 2. (Forth Worth: Thomson Tax & Accounting, 2008), p. 7-8

**The indicated value above will be utilized in Section 5.9 *Weighting and Reconciliation of Indicated Values* prior to the application of discounts or premiums.**

**All operating assets and liabilities (unless noted below) will remain in the final adjusted book value, as the valuation is a stock (equity) valuation.**

Explanation of Adjusted Book Value table on previous page:

**Reviewed Column**
This column is the actual balance sheet of the Company as of September 30, 2019, in which no adjustments have been made. The book value of Inventory (if applicable) is assumed to be accurate, and has not been separately appraised. *The Appraiser notes, certain assets/liabilities may have been re-categorized to present a more clear representation of the balance sheet.*

**Adjusted Book Value Column**
This column is the balance sheet adjusted to only include business operating assets and liabilities. Non-operating assets and liabilities include Intercompany Loans, Shareholder Loans, Real Estate Loans, personal vehicles not used in the business operations, etc. If certain fixed assets have been appraised, the fair market value of these assets will be included in this column.

**Final Adjusted Book Value Column**
This column is the balance sheet adjusted to include only assets and liabilities **included** in the Final Value represented in this report. *Assets and liabilities included in the Final Value are based on the deal structure (commonly found in the Purchase Agreement, Supplemental Questionnaire, Credit Write-up, etc.)*

**Reference numbers in last column of table:**
1. The Appraiser has analyzed the accounts receivable of the Company as of 9/30/2019. The Appraiser notes that approximately 31% of the balance is 'over 90 days past due'. As per the Supplemental Questionnaire, approximately 90% of the 'over 90 day' balance is collectable, while the 'less than 90 day' balance is estimated to be 95% collectable. Based on these estimates, the Appraiser includes 93% of the accounts receivable in the adjusted book value. The accounts receivable is included in the base purchase price and therefore is included in the final adjusted book value.
    a. The Appraiser further analyzes the industry's accounts receivable as a percentage of revenues in Section 4.7 *Industry Ratio Analysis*, which equals 15.2% of total revenues. The Company's accounts receivable balance, after adjusting for collectability, is approximately 33% of projected FYE 2020 revenues. Therefore, the Appraiser notes that there is excess accounts receivable in the adjusted book value. Because all accounts receivable is included in the final adjusted book value, no adjustment is required in the adjusted book value column. However, excess accounts receivable will be added to the value derived when calculating the Income Approach value, further analyzed in Section 5.7.1 *Capitalization of the Earnings Method.*
2. The net book value of Machinery & Equipment and Vehicles is replaced with the fair market value, per the Equipment Appraisal sourced in Section 1.7.

### 5.4.1 Liquidation Method
As previously mentioned, the liquidation methodology should also be considered when the highest and best use of the property is to liquidate, as opposed to valuing the entity as a going concern, if the interest

being valued has the right to liquidate.[70] The Liquidation Value Method is not appropriate in this case as this is an ongoing business with no immediate prospect of liquidation. ***As the subject business has a higher value as a going concern, this method is deemed not applicable by the Appraiser.***

## 5.5 Application of Market Approach

The market approach is probably the most fundamental approach in a fair market value appraisal.

Shannon Pratt states, "Smaller companies in most industries tend to sell at lower multiples of most financial variables than larger companies in the same industry. This conclusion, reached from analysis of market data, is consistent with income approach (cost of capital) research, which shows that smaller companies have higher costs of capital (higher discount rates) than larger companies. Higher discount rates in the income approach should mean lower multiples in the market approach, and this relationship does, indeed, hold true."[71]

According to Pratt's statement above, the size of a company matters. Using market data for much larger or much smaller companies than the subject company can result in erroneous conclusions. Accordingly, the market data used to determine the value for Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc. has been limited to a size range appropriate for the company.

### 5.5.1 Rules of Thumb

Qualified business appraisers generally do not consider rules of thumb to be actual appraisal methods. Rules of thumb will be explored in Section 5.11 *Review of Final Estimate Value for Reasonableness* as a "sanity check," but they are not valid appraisal methods. They will be used to verify the reasonableness of the final estimate of value, but they do not hold any weight in IBA Business Appraisal Standards.

### 5.5.2 Past Transactions

Due to the lack of applicable past transactions, this appraisal method could not be used.

### 5.5.3 Guideline Merger and Acquisition Method -Direct Market Data Method

The Appraiser addresses three databases for the Direct Market Data Method. The Appraiser has a license to use each one of these databases, and this data should not be used separate from the Appraiser's work file.

Institute of Business Appraisers Database[72]

Data for this method was obtained from The Institute of Business Appraisers, Inc. (IBA) market database. The IBA maintains the industry's largest transactional database of sales of small and mid-sized closely held businesses. As of 9/27/10, the database contains more than 34,000 transactions.

DealStats Database (formerly Pratt's Stats)[73]

Data was also obtained from DealStats®. DealStats is used by a wide variety of merger and acquisition professionals including, business appraisers, business brokers, investment bankers and venture capitalists.

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[70] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 276.
[71] Shannon P. Pratt, The Market Approach to Valuing Businesses. (New York: John Wiley & Sons, Inc., 2000), p.242.
[72] Institute of Business Appraisers - http://www.adamdata.com/ibamarketdatabase.aspx
[73] Business Valuation Resources - https://www.bvresources.com/products/deal-and-market-data

Primarily, the data found in DealStats is used to conduct the market approach to valuing a business in an effort to determine a business' fair market value or to perform financial research on the pricing of similar companies. As of 7/25/18, there are a total of 29,734 deals in this database, with over 21,310 of these transactions having a value of less than $2 Million dollars.

BIZCOMPS Database

The BIZCOMPS® database is designed for accountants, business appraisers, business intermediaries and their clients. BIZCOMPS® contains transactional information on "Main Street" businesses (service station, restaurant, convenience store, print shop, travel agent, florist, coin laundry, beauty salon, auto repair shop, video rental, day care center, etc.) dating back to 1996. Jack Sanders, who is located in San Diego, California, publishes this study. Historically, transaction data on small business transfers has been virtually nonexistent, leaving the investor or advisor to speculate about the fair market value of the small business enterprise. As of 11/21/2016, there are a total of 12,689 deals in this database, with 12,378 of these transactions having a value of less than $2 Million dollars. The median revenue is $444,000 and the median sale price is $180,000.

Raymond C. Miles, MCBA, ASA, FIBA, executive director of the Institute of Business Appraisers, published a paper entitled "In Defense of Stale Comparables," in which Miles examined the almost 10,000 entries in the database, and demonstrated that most industries are unaffected by the date of the transaction when smaller businesses are involved. Miles performed a study that examined the multiples across various industries and time periods to see if, in fact, the multiples changed. The conclusion reached was that the multiples do not appear time-sensitive, since inflation affects not only the sales price but also the gross and net earnings of the business.[74] *However, the Appraiser feels that given the recent volatility in the economy and borrowing rates, it is not unreasonable to limit the transactions for certain SIC codes to more recent years. If transactions are limited to certain dates, the Appraiser will note this in the respective section.*

According to Raymond C. Miles, MCBA, ASA, FIBA and the developer of this appraisal method, "The transactions that make up the IBA Market Data Base reflect prices that were paid by buyer based in part on the buyer's expectations with regard to the future of the business...When using the Transaction Data Method as when using any other method of valuation, the future performance (revenue or earnings, as applicable) should be forecast before applying the performance ratio (G/G or P/E) that is to be used in estimating value."[75]

The Institute of Business Appraisers states the following in reference to the number of transactions being used when analyzing the data:[76]

- Analyzing the data with five or more transactions: With at least five or six useable transactions, the mean P/G or P/E ratio will provide a reasonably accurate estimate of the mean of the market, which can then be used as a sanity check. Alternatively, the median P/G or P/E ratio can be used instead of the mean as the measure of central tendency, thus minimizing the effect of any extreme values. However, five or six transactions are too few to provide a reliable indication of market dispersion.

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[74] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses, (New York: American Institute of Certified Public Accountants, 1988), p. 150.

[75] Raymond C. Miles, Technical Studies of the IBA Transaction Database. (Plantation, Florida: The Institute of Business Appraisers, Inc., 2002), from "How to Use the IBA Market Database, Part XVIII, Interpreting Transaction Parameters, p. 4.

[76] Institute of Business Appraisers. Using the DMDM to Arrive at a Value Estimate. Retrieved from http://www.adamdata.com/ibamarketdatabase/tutorials/tutorial11.aspx

- Analyzing the data with ten or more transactions: A market sample containing at least ten but fewer than twenty transactions can provide an approximate but nevertheless useful indication of both the mean and the dispersion of the market. With the simplifying assumption of a normal probability distribution, the standard deviation can be used as an indication of market dispersion. Mathematical details are beyond the scope of this tutorial, but can be found in any text on probability and statistics.
- Analyzing the Data with twenty or more transactions: If the sample of the market data includes at least twenty or more transactions, it then becomes possible to subdivide the market into segments, such as the highest and lowest 25 percent of P/G or P/E ratios, etc. The larger the number of useable transactions, the more detailed can be this segmentation of the market. In addition, a ranking and plotting methodology can be utilized in this situation.

The Appraiser notes there is limited information available regarding the comparable transactions used in each database. Detailed financial history of the comparable companies was not made available to the Appraiser. Specific terms of the comparable transactions may not have been provided. Furthermore, the databases only provide general SIC and NAICS codes, as well as a brief description of the business sold. However, the IBA States, "the Principle of Substitution does not require identical businesses as substitutes for the subject business. Rather, this principle requires investments whose desirability is equivalent to that of the subject business."[77] Therefore, the Appraiser may include other relevant industries in his NAICS/SIC code search, for all three databases.

The Appraiser will try to remove any outliers in the data to attain the lowest possible coefficient of variation. The theory is that the valuation multiples with the lowest coefficient of variation are those with the least dispersion around their respective means and may be the better indicators of value. The value derived using these valuation multiples may be weighted more heavily than those with larger coefficient of variations.[78]

*The Appraiser notes that between all three databases, the IBA Database has consistently provided the least number of relevant transactions and the Appraiser has also consistently applied little to no weight on the IBA multiples either due to high disparity in data, a high number of outliers, or because the multiples were much higher or lower than other databases due to the earnings stream used (IBA uses EBIT plus owner's compensation as an income stream, but this does not take into consideration the fact that many small business owners (especially in the initial years) take advantage of tax sheltering methods such as depreciation and amortization, which are essentially non-cash expenses and are part of the owner's income stream). Therefore, the Appraiser chooses not to further analyze the IBA Database in this report and relies instead on the BIZCOMPS and DealStats databases.*

[77] Retrieved from the IBA website http://www.adamdata.com/ibamarketdatabase/tutorials/tutorial6.aspx
[78] DealStats FAQ's retrieved from http://www.bvmarketdata.com/defaulttextonly.asp?f=PS%20Faqs#Definitions

### 5.5.4 DealStats Database

The complete database search results for SIC Code 3444 (Sheet Metalwork) and SIC Code 3999 (Manufacturing Industries, NEC) are in the Appraisers' files, but the following statistics can be derived from the initial transaction data pull from the DealStats database:

| [illegible] | | | | | | |
|---|---|---|---|---|---|---|
| | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | | | | [illegible] | [illegible] | [illegible] |
| [illegible] | | | | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |

Shannon Pratt notes that the size of a company makes a difference in its value. Therefore, only companies with annual sales between $1,000,000 and $100,000,000 were analyzed. Additionally, the following filters were set to obtain the final 16 transactions.

- Remove all Stock transactions
- *Adjust multiple for inventory (exclude inventory from Sales Price and recalculate three multiples)*
- Remove transactions with negative EBITDA
- Remove transaction(s) with Price / SDE multiple(s) of over 10X (1) (deemed to be outlier(s) in workfile)
- Includes transaction(s) with description similar to: metal fabrication

The following can be derived from the final search result:

| [illegible] | | | | | | |
|---|---|---|---|---|---|---|
| | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | | | | [illegible] | [illegible] | [illegible] |
| [illegible] | | | | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Forecasted Subject Company | $ 34,776,559 | $ 915,265 | $ 1,054,585 | | | |
| Chosen Multiples | | | | **0.37** | **5.97** | **2.84** |

The Appraiser chose the 50th Percentile of the transactions selected (and respective Price / Sales, Price / EBITDA and Price / SDE multiples) to be most similar to the subject company, also taking into account company specific risk factors discussed in Company Specific Risk Premium sub-section of Section 5.6 *Development of a Suitable Discount Rate.*

### 5.5.5 BIZCOMPS Database

The complete database search results for SIC Code 3444 (Sheet Metalwork) and SIC Code 3999 (Manufacturing Industries, NEC) are in the Appraisers' files, but the following statistics can be derived from the initial transaction data pull from the BIZCOMPS database: (**all numbers are in thousands**)

| All Transactions (all $s in 000's) | | | | | |
|---|---|---|---|---|---|
| | Sales | SDE | Price | Price / Sales | Price / SDE |
| Low | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| High | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Mean | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Median | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Standard Deviation | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Coefficient of Variation | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Count | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |

The IBA suggests that companies within a size factor of five of the subject company can be used to determine an indication of value. Only companies with annual sales between $1,000,000 and $100,000,000 were analyzed. Additionally, the following filters were set to obtain the final 7 transactions.

- Includes transaction(s) with description similar to: metal/misc

The following can be derived from the final search result:

| Transactions Selected | | | | | |
|---|---|---|---|---|---|
| | Sales | SDE | Price | Price / Sales | Price / SDE |
| Low | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| High | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Mean | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| 50th Percentile | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Standard Deviation | | | | [illegible] | [illegible] |
| Coefficient of Variation | | | | [illegible] | [illegible] |
| Count | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |

| | | | | | |
|---|---|---|---|---|---|
| Forecasted Subject Company | $ 34,776,559 | $ 1,054,585 | | | |
| Chosen Multiples | | | | 0.56 | 2.86 |

The Appraiser chose the 50th Percentile of the transactions selected (and respective Price / Sales and Price / SDE multiples) to be most similar to the subject company, also taking into account company specific risk factors discussed in Company Specific Risk Premium sub-section of Section 5.6 *Development of a Suitable Discount Rate.*

## Included and Excluded Assets and Liabilities in the Data

The final price entered into the databases may include different assets when compared to each other. Accordingly, the Appraiser must analyze each database separately, and makes the necessary adjustments after applying the multiples derived from the respective databases.

| | *Included in the data? (Yes / No)* | | | | | |
|---|---|---|---|---|---|---|
| Database | **Cash** | **A/R** | **Inventory** | **Fixed Assets** | **Intangibles** | **Goodwill** |
| BIZCOMPS Database[79] | No | No | **No** | Yes | Yes | Yes |

Note about Inventory: This is the only database that does not include inventory in its final value, so the Appraiser must add the inventory to the value derived after applying the multiple.

| | | | | | | |
|---|---|---|---|---|---|---|
| DealStats Database[80] | No | No | Yes** | Yes | Yes | Yes |

Note about Assets: It is important to look at the "Asset Data" and "Additional Notes" sections of the DealStats transaction.

**** In this specific case, the Appraiser removes inventory from the price and recalculates the DealStats multiples to obtain multiples that do not include inventory.**

The multiples from each database are applied on the following pages, and each database treats its assets and liabilities according to the table above.

[79] Jack R. Sanders. *BIZCOMPS 96: Western States Edition of Recent Small Business Sales.* San Diego: Asset Business Appraisal, 1996, p. 6.
[80] DealStats FAQ's retrieved from dfshttp://bvmarketdata.com/defaulttextonly.asp?f=PS%20Faqs

### 5.5.6 Applying the Market Multiples

**MVIC[81] (Price) / Sales Multiple Method – DealStats Database**

The following chart shows the calculation of an indicated value using the selected MVIC / Sales Multiple for the Guideline Merger and Acquisition Method using data obtained from the DealStats Database:

**Market Approach -DealStats Database**

**PRICE / GROSS SALES MULTIPLE METHOD**

| | | | |
|---|---|---|---|
| Forecasted Sales | | $ | 34,776,559 |
| Price / Gross Sales Multiple | | | **0.37** |
| Gross Value | | | 12,762,638 |
| | | | |
| Adjustments: | | | |
| The information shown in the table from the various databases was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below: | | | |
| | | | |
| Add: Assets not Typically Included in Asset Sales: | | | |
| from Adjusted Book Value Method | | | |
| Cash and Equivalent | 214,290 | | |
| Accounts Receivable | 10,999,968 | | |
| Other Assets (incl. excess assets)/Inventory | 2,983,788 | | |
| Total Added to Value Obtained Using Multiple | | | 14,198,046 |
| | | | |
| Less: Liabilities not Typically Transferred in Asset Sales: | | | |
| from Adjusted Book Value Method | | | |
| All Liabilities (incl. excess liabilities) | (5,525,833) | | |
| Total Subtracted from Value Obtained Using Multiple | | | (5,525,833) |
| | | | |
| Estimated Value - Price / Gross Sales Multiple Method | | | 21,434,851 |
| | | | |
| **Estimated Value - Rounded** | | **$** | **21,435,000** |

The indicated value using the MVIC / Sales Multiple for the Guideline Merger and Acquisition Method using the data obtained from the DealStats Database, after rounding but prior to application of any required discounts or premiums is noted above.

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[81] Market Value of Invested Capital, or the value of the total capital invested in the company (price)

## MVIC (Price) / EBITDA – DealStats Database

The following chart shows the calculation of an indicated value using the selected MVIC / EBITDA Multiple for the Guideline Merger and Acquisition Method using data obtained from the DealStats Database:

**Market Approach -DealStats Database**
**PRICE / EBITDA MULTIPLE METHOD**

| | | |
|---|---|---|
| Earnings before Interest, Taxes, Depr., Amort. (EBITDA) (from *Section 4.9* Financial Forecast) | | $ 915,265 |
| Price / Earnings Multiple | | **5.97** |
| Gross Value | | 5,468,208 |
| Adjustments: The information shown in the table from the various databases was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below: | | |
| Add: Assets not Typically Included in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| Cash and Equivalent | 214,290 | |
| Accounts Receivable | 10,999,968 | |
| Other Assets (incl. excess assets)/Inventory | 2,983,788 | |
| Total Added to Value Obtained Using Multiple | | 14,198,046 |
| Less: Liabilities not Typically Transferred in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| All Liabilities (incl. excess liabilities) | (5,525,833) | |
| Total Subtracted from Value Obtained Using Multiple | | (5,525,833) |
| Estimated Value - Price / Gross Sales Multiple Method | | 14,140,422 |
| **Estimated Value - Rounded** | | **$ 14,140,000** |

The indicated value using the MVIC /EBITDA Multiple for the Guideline Merger and Acquisition Method using the data obtained from the DealStats Database, after rounding but prior to application of any required discounts or premiums is noted above.

## MVIC (Price) / Seller's Discretionary Earnings Multiple Method – DealStats Database

The following chart shows the calculation of an indicated value using the selected MVIC / Seller's Discretionary Earnings (SDE) Multiple for the Guideline Merger and Acquisition Method using the data obtained from the DealStats Database:

**Market Approach -DealStats Database**
**PRICE / SELLERS DISCRETIONARY EARNINGS (SDE) MULTIPLE METHOD**

| | | |
|---|---|---|
| Seller's Discretionary Earnings (from Section 4.9 Financial Forecast) | | $ 1,054,585 |
| Price / Seller's Discretionary Earnings Multiple | | **2.84** |
| Gross Value | | 2,995,361 |
| Adjustments:<br>The information shown in the table from the various databases was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below: | | |
| Add: Assets not Typically Included in Asset Sales: | | |
| Cash and Equivalent | 214,290 | |
| Accounts Receivable | 10,999,968 | |
| Other Assets (incl. excess assets)/Inventory | 2,983,788 | |
| Total Added to Value Obtained Using Multiple | | 14,198,046 |
| Less: Liabilities not Typically Transferred in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| All Liabilities (incl. excess liabilities) | (5,525,833) | |
| Total Subtracted from Value Obtained Using Multiple | | (5,525,833) |
| Estimated Value - Price / Gross Sales Multiple Method | | 11,667,574 |
| **Estimated Value - Rounded** | | **$ 11,668,000** |

The indicated value using the MVIC / Seller's Discretionary Earnings (SDE) Multiple for the Guideline Merger and Acquisition Method using the data obtained from the DealStats Database, after rounding but prior to application of any required discounts or premiums is noted above.

## Price / Sales Multiple Method – BIZCOMPS Database

The following is a chart showing the calculation of an indicated value using the selected Price / Sales Multiple for the Guideline Merger and Acquisition Method using the data obtained from the BIZCOMPS Database:

**Market Approach - BIZCOMPS Database**
**PRICE / GROSS SALES MULTIPLE METHOD**

| | | |
|---|---|---|
| Forecasted Sales (from Section 4.9 Financial Forecast) | | $ 34,776,559 |
| Price / Gross Sales Multiple | | **0.56** |
| Gross Value | | 19,405,320 |
| Adjustments: The information shown in the table from the various databases was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below: | | |
| The BIZCOMPS database transactions do not include inventory, so inventory must be added to the gross value. | 167,553 | |
| Add: Assets not Typically Included in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| Cash and Equivalent | 214,290 | |
| Accounts Receivable | 10,999,968 | |
| Other Assets (incl. excess assets) | 2,816,235 | |
| Total Added to Value Obtained Using Multiple | | 14,198,046 |
| Less: Liabilities not Typically Transferred in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| All Liabilities (incl. excess liabilities) | (5,525,833) | |
| Total Subtracted from Value Obtained Using Multiple | | (5,525,833) |
| Estimated Value - Price / Gross Sales Multiple Method | | 28,077,533 |
| **Estimated Value - Rounded** | | **$ 28,078,000** |

The indicated value using the Price / Sales Multiple for the Guideline Merger and Acquisition Method using the data obtained from the BIZCOMPS Database, after rounding but prior to application of any required discounts or premiums is noted above.

## Price / Seller's Discretionary Earnings (SDE) Multiple Method – BIZCOMPS Database

The following is a chart showing the calculation of an indicated value using the selected Price / SDE Multiple for the Guideline Merger and Acquisition Method using the data obtained from the BIZCOMPS Database:

**Market Approach - BIZCOMPS Database**
**PRICE / SELLERS DISC. EARNINGS (SDE) MULTIPLE METHOD**

| | | |
|---|---|---|
| Seller's Discretionary Earnings (from Section 4.9 Financial Forecast) | | $ 1,054,585 |
| Price / Seller's Discretionary Earnings Multiple | | **2.86** |
| Gross Value | | 3,013,990 |
| Adjustments: | | |
| The information shown in the table from the various databases was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below: | | |
| The BIZCOMPS database transactions do not include inventory, so inventory must be added to the gross value. | 167,553 | |
| Add: Assets not Typically Included in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| Cash and Equivalent | 214,290 | |
| Accounts Receivable | 10,999,968 | |
| Other Assets (incl. excess assets) | 2,816,235 | |
| Total Added to Value Obtained Using Multiple | | 14,198,046 |
| Less: Liabilities not Typically Transferred in Asset Sales: | | |
| from Adjusted Book Value Method | | |
| All Liabilities | (5,525,833) | |
| Total Subtracted from Value Obtained Using Multiple | | (5,525,833) |
| Estimated Value - Price / Gross Sales Multiple Method | | 11,686,203 |
| **Estimated Value - Rounded** | | **$ 11,686,000** |

The indicated value using the Price / SDE Multiple for the Guideline Merger and Acquisition Method using the data obtained from the BIZCOMPS Database, after rounding but prior to application of any required discounts or premiums is noted above.

### 5.5.7 Reconciliation of Values Derived from the Market Approach

The following is a summary of the indicated values determined from each database used in the Market Approach:

**RECONCILIATION OF MARKET APPROACH**

| **Market Approach**<br>**Direct Market Data Method** | **Indicated Value** | **Confidence Level** | **Weighted Estimate** | Coefficient of Variance |
|---|---|---|---|---|
| **DealStats Data:** | | | | |
| *Price / Sales* | 21,435,000 | 0.0% | $ - | *0.73* |
| *Price / EBITDA* | 14,140,000 | 20.0% | 2,828,000 | *0.55* |
| *Price / Seller's Discretionary Earnings* | 11,668,000 | 40.0% | 4,667,200 | *0.47* |
| **BIZCOMPS Data:** | | | | |
| *Price / Sales* | 28,078,000 | 0.0% | - | *0.51* |
| *Price / Seller's Discretionary Earnings* | 11,686,000 | 40.0% | 4,674,400 | *0.43* |
| (No Discounts or Premiums) | | | | |
| Market Approach Value | | 100.0% | 12,169,600 | |

**Explanation of Weightings:**

*Price to Sales Multiples*

Although many business brokers use the Price to Sales multiple to estimate the value of a business, *Revenue Ruling 59-60* suggests "Earnings may be the most important criterion of value in some cases..."[82] Additionally, small business owners are primarily concerned with the return on their investment and their true cash flow. There are many factors which can affect the profitability of a business that falls within the NAICS category 'Sheet Metal Work Manufacturing', namely cost of goods sold, cost of labor, rent and marketing, which can vary drastically depending on the management and other specifics. Accordingly, the Appraiser assigns a total weight of 0.0% to both Price to Sales ratios.

*Price to Earnings Multiples*

DealStats uses EBITDA as one of its income streams, but this does not include the owner's compensation, which is essentially part of an owner operator's true cash flow. However, this is often used by borrowers and lenders to determine the debt servicing ability of a business, as well as the earnings capacity after paying a manager. Many business brokers use this earnings stream when entering data into the comparable databases. There are 9 comparable transactions in this data, and the coefficient of variance is 0.55, which is reasonable. Accordingly, the Appraiser assigns 20.0% weight to the Price / EBITDA multiple. The theory is that the valuation multiples with the lowest Coefficient of Variation are those with the least dispersion around their respective means and may be the better indicators of value. The value derived using these valuation multiples may be weighted more heavily than those with larger Coefficient of Variations.[83]

DealStats and BIZCOMPS use Seller's Discretionary Earnings as an income stream. This is calculated by adding owner's compensation back to EBITDA, which is essentially the true cash flow of a small

[82] Internal Revenue Service, *Revenue Ruling 59-60*, Sec. 5. Weight to Be Accorded Various Factors, paragraph. (a).
[83] DealStats FAQ's retrieved from http://www.bvmarketdata.com/defaulttextonly.asp?f=PS%20Faqs#Definitions

business owner that operates his or her own business. Accordingly, these two multiples were assigned 80.0% of the total weight. The BIZCOMPS data for this multiple had a coefficient of variance of 0.43 (with 7 transactions), while the DealStats data had a coefficient of variance of 0.47 (with 10 transactions). Therefore, the Appraiser assigns 40.0% weight on the BIZCOMPS multiple and 40.0% on the DealStats multiple.

**After applying the aforementioned weights to each value derived from the market databases, the final weighted average value derived in the Market Approach is $12,169,600. This value will be utilized in Section 5.9 *Weighting and Reconciliation of Indicated Values.***

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## 5.6 Development of a Suitable Discount Rate

Discount rates and capitalization rates are not the same. A discount rate is the required rate of return, a yield rate used to convert future receipts into present value. The rate of return represents the *total rate of return* expected by the market, the rate necessary to attract capital to the subject investment.[84]

The capitalization rate is not a rate of return; it is a divisor used to convert a future return into an indication of value. The capitalization rate *plus* the long-term sustainable rate of growth in the selected return combine to provide the rate of return.[85]

**Capitalization Rate = Discount Rate - Long Term Sustainable Growth Rate**
or
**Discount Rate = Capitalization Rate + Long Term Sustainable Growth Rate**

According to IRS Revenue Ruling 59-60, "determination of the proper capitalization rate presents one of the most difficult problems in valuation." Certain items must be taken into consideration such as: "1) the nature of the business; 2) the risk involved; and 3) the stability or irregularity of earnings."[86]

Every discount rate, regardless of how it is derived, includes the following basic components: (1) the risk-free rate of return, (2) the equity risk premium, and (3) the specific company risk premium.[87]

There are several methods of developing a discount rate. When we discount the net cash flow to invested capital, the appropriate discount rate is the weighted average cost of capital (WACC).[88]

Since part of the enterprise is financed with lower-cost, tax deductible debt, it arrives at a blended (weighted average) discount rate, which take into account the proportion of the capital structure financed with debt at its cost, and the proportion financed with equity at its cost.[89]

The formula for WACC is shown below:

$$WACC = (wE \times kE) + (wD \times kD(1 - t))$$

wE = Weight of equity in the capital structure
kE = Cost of equity
wD = Weight of debt in the capital structure
kD = Cost of debt
t = Marginal tax rate

[84] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 324.
[85] Ibid., p. 324.
[86] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 6. Capitalization Rates.
[87] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 326.
[88] Shannon Pratt. Cost of Capital: Estimation and Applications. Second Edition (Hoboken, NJ: John Wiley & Sons, 2002), p 16
[89] P. 1215

The cost of debt is the interest rate at which a hypothetical buyer can attain bank financing. Because the debt will be personally guaranteed, the Appraiser will add 300 basis points to the prime rate as a premium. Three percent (or 300 basis points) can be used as an estimate for adding to the cost of debt to reflect personal guarantees.[90] The Prime rate as of September 30, 2019 is 5.00%. Adding 3.0% to that will be 8.00%. Accordingly, the cost of debt will be calculated at 8.00%. The tax rate applied will be the average corporate tax rate (as discussed in Income Tax Adjustments in this same section below) derived by multiplying the income taxes by the forecasted year's pre-tax net income.

The cost of equity can be derived by using the buildup method. Many appraisers, especially those who work with smaller privately held companies, use the build-up method of developing a discount rate [cost of equity].[91] The build-up method embodies the 3 components previously described, and two additional components, all of which are described below:

1) Risk Free Premium – This is also known as the "safe rate" or the "cost of money". It's the minimum return an investor would accept for an investment that is deemed to be risk free. As short term US Treasury Bonds do not match typical holding periods for most investors, the typical rate used for the risk-free rate is the 20-year bond rate. While a "spot rate" was historically preferred, new analysis in the Duff & Phelps 2017 Valuation Handbook indicates that using a non-normalized risk-free rate (with no corresponding adjustments to the ERP) would likely lead to an underestimated cost of equity capital, and so a "normalization" adjustment may be considered appropriate. As September 30, 2019, Duff & Phelps estimates the normalized yield on the US 20-year government bonds to be 3.00%.
2) Equity Risk Premium – Also called the "general risk premium", this component takes into consideration market perceptions and the expectations of a broad measure of the market.[92] Typically, the premium is estimated through the use of historical data. The ERP is the historical premium one could expect if investing in large stocks (e.g. S&P 500) as opposed to investing in riskless assets. The historical equity risk premium can be calculated by subtracting the long-term average of the income return on the riskless asset (Treasuries) from the long term average stock market return (measured over the same period as that of the riskless asset).[93] The conditional equity risk premium calculated by Duff & Phelps, LLC is 5.50%.[94]
3) Size Premium - A size premium is the additional return expected for incurring additional risk of investing in companies smaller than the market index.[95] Duff & Phelps[96] (previously, Ibbotson Associates was relied upon) have documented the size effects by dividing companies up into 10 deciles, according to market value. These are group in different ways:
    a. The deciles can be Mid-Cap (3-5), Low-Cap (6-8) and Micro-Cap (9-10) stocks.

[90] Shannon Pratt and Roger Grabowski. Cost of Capital: Applications and Examples. Fifth Edition (Hoboken, NJ: John Wiley & Sons, 2014), p 535
[91] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 334.
[92] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 327.
[93] Ibbotson Associates, Stocks, Bonds, Bills & Inflation – 2013 Yearbook, (Chicago: Ibbotson Associates, Inc., 2013), p. 71
[94] Duff & Phelps, LLC, 2018 Valuation Handbook – Guide to Cost of Capital, (Chicago: Duff & Phelps, LLC, 2018),
[95] Shannon P. Pratt, Business Valuation Body of Knowledge. Second Edition. (New Jersey: John Wiley & Sons, Inc., 2008), p. 107.
[96] Duff & Phelps, LLC, 2018 Valuation Handbook – Guide to Cost of Capital, (Chicago: Duff & Phelps, LLC, 2018), CRSP Deciles Size Premia Study: Key Variables

b. The deciles can be broken down from 1 through 10, with 1 being the largest and 10 being the smallest.
   i. The 10th decile is further broken up into 10 smallest, 10a (which is further broken down to 10w and 10x) and 10b (which is further broken down to 10y and 10z).
   ii. The size premium for decile Micro-Cap (9-10) represents companies with market capitalization between $2.455 million and $727.843 million (2.46%). This range seems too large when compared to the subject Company's capitalization. The size premium for the 10th decile represents companies with market capitalization between $2.455 million and $321.578 million (5.22%), which is closer to the Company's estimated market capitalization. Often times, appraisers use the smallest component of the breakdown of the 10th decile, which would be 10z in this case (11.14%), since the subject Company's market capitalization is closest to $2.455 million - $109.406 million, which is the smallest market capitalization range in the report. However, there are certain studies that show concern that start-up companies, highly leveraged companies and distressed companies may be included in the smaller deciles and therefore, many practitioners rely on the 10th decile or the Micro-Cap decile to use in the buildup method. Furthermore, many companies in the lower 10th deciles show signs of being no better managed than small private companies. Therefore, the Appraiser choses to use the 10th decile size premium of 5.37%. Shannon Pratt has stated that in most situations, much of what is listed among the specific company risk factor is captured in the size premium. Therefore, although the Appraiser is using 5.37% rather than 11.14%, it should be noted that a company specific premium will still be calculated and added in the buildup method (below) to offset using the lower size premium.

4) Industry Premium – Traditionally, the Appraiser looks at aspects and characteristics of the industry in which the subject company participates to determine the magnitude of the industry risk premium. Duff & Phelps, LLC has developed an industry premium methodology that appraisers can now reference and cite in their appraisals reports.[97] The industry premium for Code 344 - Fabricated Structural Metal Products is -0.33%.
5) Company Specific Risk Premium – This component of the discount rate provides for the specific risk characteristics of the appraisal subject. These risk elements are not covered by the equity risk premium. There is no objective source of data to properly reflect or quantify the specific company risk premium. It is a matter of judgment and experience.[98]

Development of the company specific risk premium considered the following factors:

1) Financial position of the Company – As per Section 4.7 *Financial Ratio Analysis,* this is considered a moderate risk factor.
2) Level of diversification / customer or supplier concentration - As per Section 2.8 *Products and Services,* this is considered a moderate to high risk factor.
3) Depth and quality of management / personal goodwill – As per Section 2.6 *Management,* this is considered a moderate risk factor.
4) Competition – As per Section 2.9 *Competition,* this is considered a moderate to high risk factor.
5) Barrier to funds or Access to capital (difficulty for small businesses to borrow funds) – The Company may have difficulties trying to source financing through a business line of credit due to lack of available collateral. This is considered a non-risk factor.

[97] Ibid., Exhibit 5-7

[98] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 327.

6) Expected growth or decline of the business / ability to achieve projections – As per Section 4.9 *Financial Forecast,* the Company's projections are reasonable based on recent financial performance, but do represent a slight decline in sales and earnings. This is considered a moderate risk factor.

Based on the aforementioned analysis of the risks associated with the subject Company, the Appraiser has determined the Company Specific Risk Premium to equal 1.00%.

The following table lists the components of the discount rate for equity using the build-up method for Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc.:

**Build Up Method for Cost of Equity**

| | |
|---|---|
| Risk Free Rate | 3.00% |
| Equity Risk Premium | 5.50% |
| Industry Risk | -0.33% |
| Size Premium | 5.37% |
| Company Specific Risk Premium | 1.00% |
| Total Cost of Equity | 14.54% |
| Total Cost of Equity - Rounded | **14.50%** |

The weight of debt and equity are the respective percentages applied to the cost of debt and the cost of equity. If a controlling interest is to be valued and the standard of value is *fair market value*, an argument can be made that an industry-average capital structure should be used, because a control buyer would have the power to change the capital structure and the industry average could represent the most likely result.[99] "However, the available industry specific data is derived from industry specific publicly traded companies, and it may be unreasonable to expect the subject company to achieve these capital structures, given the current conditions of the company itself compared to the industry as a whole. By expanding the capital structure data to include all industries, any outliers in the industry specific publicly traded financial markets are normalized. Therefore, the capital structure for all industries is assessed.

The Appraiser used the Average Debt to Market Value of Invested Capital (MVIC) ratio for the smallest portfolio ranking for all industries (average MVIC of $187MM) as calculated by Duff and Phelps, LLC[100]. The ratio as a percentage is 22.75%, and it includes 218 companies.

[99] Shannon Pratt. Cost of Capital: Estimation and Applications. Second Edition (Hoboken, NJ: John Wiley & Sons, 2002), p 52

[100] Duff & Phelps, LLC, 2018 Valuation Handbook – Guide to Cost of Capital, (Chicago: Duff & Phelps, LLC, 2018), Exhibit C-4.

**Weighted Average Cost of Capital**

| | | | | |
|---|---|---|---|---|
| Weight of Debt | | | 22.75% | |
| Cost of Debt | | | | |
| Long Term Interest Rate | | 8.00% | | |
| Tax Rate* | 14.17% | | | |
| One Minus Tax Rate | | 85.83% | | |
| Total Cost of Debt | | | 6.87% | |
| Weighted Cost of Debt | | | | 1.56% |
| Weight of Equity | | | 77.25% | |
| Cost of Equity (from Build Up Method) | | 14.50% | | |
| Total Cost of Equity | | | 14.50% | |
| Weighted Cost of Equity | | | | 11.20% |
| Weighted Average Cost of Capital (Discount Rate) | | | | 12.76% |

**The tax rate applied is the tax rate as discussed in Income Tax Adjustments in this same section below derived by dividing the implied income taxes by the forecasted year's adjusted pre-tax net income.*

Another rate used in the income approach is the expected long-term growth rate. Based on the historical growth of the company, and taking into consideration the present economic and industry outlooks, and finally the financial stability of the subject business, the long-term sustainable growth rate was determined to be **2.5%.**

From above we know that **Cap Rate = Discount Rate - Long Term Sustainable Growth Rate**

Accordingly, we determine the capitalization rate is **10.30%**.

| | |
|---|---|
| Total Discount Rate (WACC) | 12.76% |
| Less: Long Term Growth Rate | 2.50% |
| Capitalization Rate - Rounded | 10.30% |

### Cash Flow Adjustments

Primary consideration should be given to the dividend-paying capacity of the company rather than to dividends actually paid in the past.[101] In valuing the entire invested capital of a company or project by discounting or capitalizing expected cash flows, net cash flow to invested capital is defined as:[102]

Net Income after taxes
\+ Non Cash Charges (depreciation, amortization, etc.)
\+ Interest expense (net of the tax effect (interest expense x [1 - tax rate]))
\- Capital Expenditures
+/- Changes in working capital
= Net cash flow to invested capital

In other words, net cash flow to invested capital includes interest, because invested capital includes the debt on which the interest is paid, whereas net cash flow to equity does not. When we discount the net

[101] Internal Revenue Service, *Revenue Ruling 59-60,* Sec. 4. Factors to Consider, paragraph .02(f).
[102] Shannon Pratt. Cost of Capital: Estimation and Applications. Second Edition (Hoboken, NJ: John Wiley & Sons, 2002), p 16

cash flow to invested capital, the appropriate discount rate is the weighted average cost of capital (WACC).[103] The Appraiser uses historical weighted income streams, as discussed in *Section 4.9* Financial Forecast.

The following chart illustrates the calculation of projected Net Cash Flow to Invested Capital:

| | 2016 Audited FYE 2017 | 2017 Audited FYE 2018 | 2018 Audited FYE 2019 | Projected - Yr 1 FYE 2020 |
|---|---|---|---|---|
| **Adjusted Pre-tax Net Income (from Sec 4.9)** | $ 954,636 | $ 1,203,671 | $ 533,893 | $ 633,734 |
| **Add: Depreciation (actual)** | 79,718 | 79,862 | 179,023 | 179,023 |
| **Less: Depreciation (estimated based on cap ex)** | (129,870) | (129,870) | (129,870) | (129,870) |
| **Depreciation Adjusted Pre-tax Net Income** | $ 904,483 | $ 1,153,662 | $ 583,046 | $ 682,887 |
| **Weight** | **0%** | **0%** | **70%** | **30%** |
| Weighted Depreciation Adjusted Pre-tax Net Income | $ 612,998 | | | |
| Sustainable Growth Rate | 2.5% | | | |
| Projected Adj. Pre-tax Net Income | 628,323 | | Tax Rate | |
| | | | 14.17% | |
| Less: Allowance for Corp. Income Taxes | (89,054) | | | |
| Forecasted Net Income After Taxes | $ 539,269 | | | |
| Add: Weighted Amortization | - | | | |
| Add: Weighted Depreciation | 133,142 | | | |
| Add: Weighted Interest (after tax effect) | 128,803 | | | |
| Less: Capital Expenditures | (150,000) | | | |
| Less: Working Capital Needed to Support Growth | (189,387) | | | |
| Net Cash Flow to Invested Capital | $ 461,828 | | | |

See notes below and on the next page for calculation explanations for each line item above.

**Historical Weighted Averages** are calculated for the same reasons as described in Section 4.9 *Financial Forecasts.*

**Income Tax Adjustments:** A 'C' Corporation is a typical tax-paying corporation that pays taxes at the entity level. Limited Liability Companies (and 'S' Corporations) do not pay income taxes at the entity level; the shareholders pay income taxes at the personal level. As long as the discount or capitalization rates that are used are consistent with the benefit stream being discounted or capitalized, it doesn't matter if an appraiser uses pretax or after-tax income streams. However, since the Appraiser is deriving the discount rates from publicly traded companies that are 'C' Corporations and use after-tax income streams, the Appraiser has to adjust for taxes, as if the company were a tax-paying corporation like the ones used to derive discount rates. Once the operating adjustments have been added or subtracted from the original net income or loss, a tax adjustment must be made on the adjusted earnings.

The Appraiser assumes that a hypothetical buyer would choose to purchase the Company through an asset sale with either an S Corporation or a Limited Liability Company, both of which are pass-through tax entities. The Appraiser calculated an effective tax rate of based on the Delaware Open MRI Associates, P.A. v. Howard B Kessler case in 2006 (unless the forecasted pre-tax net income is negative, in which case a tax rate is not applicable). In rendering the Court's decision, the Vice Chancellor applied a 29.4% effective tax rate to the earnings of the subject, treating the S Corporation shareholder as receiving the full

[103] Shannon Pratt. Cost of Capital: Estimation and Applications. Second Edition (Hoboken, NJ: John Wiley & Sons, 2002), p 16

benefit of untaxed dividends, but equating its after-tax return to the after-dividend return to a C Corporation shareholder.[104].

| | C Corporation Returns | S Corporation Returns | Tax Affecting to Equate Returns |
|---|---|---|---|
| Income before income tax | $100 | $100 | $100 |
| Corporate income tax | 40.0% | - | 29.4% |
| Available earnings | $60 | $100 | $71 |
| Dividend or personal income tax rate | 15.0% | 40.0% | 15.0% |
| Cash available for shareholders | $51 | $60 | $60 |

It should be noted that the 29.4% effective tax rate was based on tax rates prior to the Tax Cuts and Jobs Act of 2017 (TCJA). As per an article in the Journal of Forensic & Investigative Accounting, the Court of Chancery of Delaware model needs to be revised based on changes in tax law.[105] In calculating the effective tax rate of the Company, the Appraiser has taken into account changes in tax law (TCJA) and the Company's projected adjusted pre-tax net income, as illustrated in the table below:

**Court of Chancery of Delaware Model**
**37% Federal + 5% State with 199A Deduction**

| | C Corp | S Corp | S Corp Valuation |
|---|---|---|---|
| Pre-Tax Income | $ 100.00 | $ 100.00 | $ 100.00 |
| Corporate Tax Rate | 26.0% | 0.0% | 14.2% |
| Available Earnings | $ 74.00 | $ 100.00 | $ 85.83 |
| Dividend/Personal Tax Rate | 23.8% | 34.6% | 23.8% |
| Available To Shareholders | $ 56.39 | $ 65.40 | $ 65.40 |

Corporate tax rates consist of a federal tax flat rate of twenty-one percent and an average state tax rate of five percent (based on the rounded average of all 50 state tax rates). Dividend rates are based on long-term capital gains tax rates and personal tax rates are based on individual tax rate schedules, assuming a hypothetical buyer would file a 'married filing joint return'.

**Amortization** is a non-cash expense. The prior years' weighted amortization as a percentage of sales was added back to future years.

**Depreciation** is a tax deferral method that allows a business owner to expense the cost of an asset over the span of several years. Capital expenditures always come before depreciation. A company cannot expense depreciation on an asset it has not acquired. Thus, future depreciation into perpetuity can only come from future capex.[106] *Depreciation cannot exceed future capex into perpetuity; therefore depreciation should be adjusted to capex.* The Appraiser adds back the historical depreciation to each year's adjusted pre-tax net income, and subtracts out future depreciation based on the future capital expenditures described below (because capital expenditures will slightly exceed depreciation due to inflationary pressure in a stable business, capex is estimated to exceed depreciation by 15.5 percent).

[104] Shannon Pratt, Roger Grabowski. Cost of Capital: Applications and Examples. Fifth Edition. (John Wiley & Sons, Inc., Hoboken, NJ), p. 672
[105] Russo, Charles J. and DiGabriele, James A. "Impact of the Tax Cuts and Jobs Act on the Valuation of S Corporations" *Journal of Forensic & Investigative Accounting* Volume 10 (2018). 153-167
[106] John F Coffey, The Capex Adjustment, *The Value Examiner*, November/December 2009.

After income taxes are calculated, the prior years' weighted (adjusted) depreciation as a percentage of sales was calculated. This percentage of sales was applied to the forecasted sales to approximate the ongoing deprecation into future years. This takes into account that as sales increase in future years, new equipment will be purchased and depreciation will adjust accordingly.

**Capital Expenditures** are an estimate of the amount the company will need to spend in a representative year (not necessarily a specific year) to acquire additional plant and equipment. The Supplemental Questionnaire states a new drafting program will need to be purchased within the next three years, at an approximate cost of $100,000. The Company typically spends $150,000 to $200,000 on capital expenditures and equipment in a typical year. Therefore, the Appraiser estimates that $150,000 per year is required to maintain equipment levels and update leasehold improvements based on the business type and amount of equipment required.

**Changes in Working Capital** are calculated from the balance sheet by subtracting the previous year's working capital from the working capital of the year in question. Working capital for each year is calculated by subtracting current liabilities from current assets. The change in working capital represents the ongoing funds expected to be used to meet the Company's current, short-term obligations; for example by paying for operating expenses, such as purchases, rent, and salaries, or to acquire/replace equipment.

Working capital requirements were assessed as a percentage of the annual changes in sales between the weighted sales and the projected weighted sales in Section 4.9 *Financial Forecast*. For this analysis, working capital requirements were based on industry data (from RMA data sourced in Section 4.7 *Industry Ratio Analysis)*, which concluded to be 22.33% of sales. Note that this percentage has been derived from the industry data's debt-free working capital balances, which excludes both Notes Payable – Short Term and Current Mat. – LTD', since it is inappropriate to include these in a cash flow to invested capital model. [107]

## 5.7 Application of the Income Approach

The capitalization method should be used when the future benefit stream will be constant. The discounting future earnings method should be used when the future income stream is expected to vary. The selection to use one of these methods is mutually exclusive; both will generate the exact same answer if applied properly so there is no point in using both methods to appraise the same company.[108]

There are many factors that will cause the future earnings of the subject business to vary for the near future, including changes in rent, amortization, depreciation, and long-term interest bearing debt. As seen in Section 4.9 *Financial Forecast*, the growth of the subject company's income stream is projected to be stable. Accordingly, the Capitalization of Earnings Method will be used in the Income Approach.

### 5.7.1 Capitalization of Earnings Method

The Appraiser capitalized the forecasted Net Cash Flow to Invested Capital calculated in Section 5.6 ($ 461,828) by the capitalization rate derived in the same section (10.30%). The chart on the following page illustrates the application of the Single Period Capitalization Method utilizing the company's control adjusted net cash flow:

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[107] Jay E. Fishman, James R. Hitchner, and Shannon P. Pratt, A Consensus View: Q&A Guide to Financial Valuation. (New Jersey: Valuation Products and Services, LLC, 2016), p. 24-25.
[108] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 210-211.

**Capitalization of Earnings Method**

| | | |
|---|---|---|
| Forecasted Net Cash Flow to Invested Capital | | $ 461,828 |
| Capitalization Rate | | 10.30% |
| **Value of Invested Capital (controlling, marketable basis)** | | **4,483,765** |
| Deduct: Interest Bearing Debt | | (2,080,907) |
| **Equity Value (controlling, marketable basis)** | | 2,402,858 |
| Adjustments for Asset / Liabilities Not Included in Sale: The equity value generated from this method includes all operating assets and liabilities. The value must be adjusted for any operating assets or liabilities not included in the sale. | | |
| **Liabilities** | | |
| Add: Total Liabilities Not Included In Sale (or Value) | - | |
| **Current Assets** | | |
| Deduct: Cash and Equivalents Not Included In Sale (or Value) | - | |
| *No Excess Cash Included in the Value* | - | |
| Deduct: Accounts Receivable Not Included In Sale (or Value) | - | |
| *Add: Excess Accounts Recievable* | 5,962,395 | |
| Deduct: Inventory Not Included In Sale (or Value) | - | |
| *No Excess Inventory Included in the Value* | - | |
| Deduct: Other Current Assets Not Included in Sale (or Value) | - | |
| **Other Assets/Liabilities** | | |
| Add: Excess Assets Included in Sale (or Value) - Deposits | 74,291 | |
| Add: Excess Assets Included in Sale (or Value) - Costs In Excess | 2,723,897 | |
| Deduct: Other Assets Not Included in Sale (or Value) | - | |
| Deduct: Excess Liabilities Included in Sale (or Value) - Billings In Excess | (112,060) | |
| Deduct: Excess Liabilities Included in Sale (or Value) - Long Term | - | |
| | | 8,648,523 |
| **Indicated Value - Rounded (Prior to Application of Discounts)** | | **$ 11,051,000** |

(Assets and Liabilities are derived from Section 5.4 *Application of the Asset Approach.*)

**The estimated value derived by this method is $11,051,000. This value will be utilized in Section 5.9 *Weighting and Reconciliation of Indicated Values* prior to the application of any required discounts or premiums.**

## 5.8 Adjustments for Premiums and Discounts

Before weighting and reconciling the values determined in this report, the need for adjustments for discounts and premiums must be considered. The type and size of the discount(s) and premium(s) will vary depending on the starting point. The starting point will depend on which methods of valuation were used during the appraisal, as well as on other factors, such as normalization adjustments and the sources of the information used to derive multiples or discount rates.[109]

The following are common discounts and premiums:

1) Control Premium – This is used to determine the control value of a closely held business when its feely traded minority value has been determined. A control premium is used to determine the control value when the freely traded minority value is the starting point.[110]

[109] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, Second Edition (New York: American Institute of Certified Public Accountants, Inc., 2002), p. 357.
[110] Ibid., p. 359.

2) Minority Discounts (Lack of Control Discount) – This is a reduction in the control value of the appraisal subject that is intended to reflect the fact that a minority stockholder cannot control the daily activates or policy decisions of an enterprise, leading to a reduction in value. This is basically the opposite of a premium for control. This type of discount is used to obtain the value of a non-controlling interest in the appraisal subject when a control value is the starting point.[111]
3) Discount for Lack of Marketability (DLOM) – This is used to compensate for the difficulty of selling shares of stock that are not traded on a stock exchange compared with those that can be traded publicly. Publicly traded stocks frequently have an element of liquidity that closely held shares do not. This is the reason that DLOM may be applied (to closely held businesses).[112]
4) Illiquidity Discounts – This is a DLOM for controlling interests. Controlling interests are more marketable than non-controlling interests, therefore the size if the DLOM used is smaller if it is being applied to a controlling interest or larger if it is being applied to a non-controlling interest.

It should be understood that the estimates of value that each method yields has an effect on which premiums or discounts are applicable. The following chart lists each of the methods of valuation used in this report and the applicable starting point from a control and marketability standpoint:

| | Types of Value | |
|---|---|---|
| **Method** | **Control/Minority** | **Marketable/Nonmarketable** |
| **Market Approach** | | |
| Guideline Merger and Acquisition Method | Control | Non-marketable |
| **Asset Based Approach** | | |
| Adjusted Book Value | Control | Non-marketable |
| **Income Approach** | | |
| Single Period Capitalization | Control | Marketable |

The subject interest's stock position is a controlling, non-marketable (non-freely trading) interest. The appraisal methods used in this appraisal result in a value on a controlling interest basis, and because the desired conclusion of value is on a controlling interest basis, no adjustment for a Control Premium is needed. Because one hundred percent of the common stock is being appraised (which represents a controlling interest), a Minority Discount is not applicable. In this report, the multiples used in the market approach already reflect a lack of marketability. Therefore, a Discount for Lack of Marketability is not applied. Because the capitalization rate in the Income Approach is based on publicly traded companies that are highly liquid, an Illiquidity Discount will be applied to this approach, as discussed below.

[111] Ibid., p. 366.
[112] Gary Trugman. Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Business, p. 370.

### 5.8.1 Illiquidity Discount

When valuing a controlling interest in the company, a marketability discount must be identified that will be sufficient to convert the Control Marketable Value to a Control Non-Marketable Value.

As a closely held company cannot be sold in the same manner as a financial stock (i.e.: calling your securities broker and telling him to sell the stock on the following day), the company must typically either be taken public, sold privately to an outside party, or sold to other existing shareholders. Each of these transactions can be time consuming and can be expensive. It is for this reason that an illiquidity discount must be given.

This discount should approximate the cost of selling the company, if a public offering is not feasible. As this company is a closely held business that is not in a financial position to go public, an estimated cost of 3.1% will be considered to sell the business (unless the final value in the income approach is a negative number, in which case the illiquidity discount is not applicable). This includes a broker's fee, accounting and legal fees, and other miscellaneous transaction expenses (varies based on size of company).

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### 5.8.2 Applications of Discounts and Premiums

The following is a summary of the indicated values determined from each appraisal method used and the applicable values and discounts and premiums that apply to each:

**ASSET APPROACH**

| | | | |
|---|---|---|---|
| ***Adjusted Book Value Method*** | | $ | 10,297,000 |
| | This approach generates a Control, Non-Marketable (Control, As if Not Freely Traded) Value | | |
| Control Interest: | No Discounts | | |

**MARKET APPROACH**

| | | | |
|---|---|---|---|
| ***Guideline Merger and Acquisition Method*** | | | |
| ***DealStats Price / Sales Method*** | | $ | 21,435,000 |
| ***DealStats Price / EBITDA*** | | $ | 14,140,000 |
| ***DealStats Price / Seller's Discretionary Earnings Method*** | | $ | 11,668,000 |
| ***BIZCOMPS Price / Sales Method*** | | $ | 28,078,000 |
| ***BIZCOMPS Price / Seller's Discretionary Earnings Method*** | | $ | 11,686,000 |
| | This approach generates a Control, Non-Marketable (Control, As if Not Freely Traded) Value | | |
| Control Interest: | No Discounts | | |

**INCOME APPROACH**

| | | | |
|---|---|---|---|
| ***Single Period Capitalization Method - Control Adjusted*** | | $ | 11,051,000 |
| | This approach generates a Control, Marketable (Control, As if Freely Traded) Value or a Non-Control, Marketable (Minority, As if Freely Traded) Value, depending on whether or not adjustments are made to the forecasted income stream. Since only control adjustments are made, a Control, Marketable Value is derived in this case. As the discount rate is derived from public markets, an Illiquidity discount must be assessed on the Control Interest, to account for the cost of sale. | | |
| Control Interest: | 3.1% Illiquidity Discount | | |

## 5.9 Weighting and Reconciliation of Indicated Values

According to the *Uniform Standards of Professional Appraisal Practice* (USPAP), "an appraiser must reconcile the quality and quantity of data available and analyzed within the approaches, methods, and procedures used. An appraiser must reconcile the applicability and relevance of the approaches, methods and procedures used to arrive at the value conclusion(s). The value conclusion is the result of the Appraiser's judgment and not necessarily the result of a mathematical process."[113] An explanation is provided below the table.

**RECONCILIATION**

**100% Control Interest in the Company**

| Valuation Method: | Indicated Value | Discount/ Premium Rate | Confidence Level | Weighted Estimate |
|---|---|---|---|---|
| **Asset Approach** | | | | |
| *Adjusted Book Value Method* | 10,297,000 | | | |
| (No Discounts or Premiums) | - | 0% | | |
| Adjusted Value | 10,297,000 | | 0% | - |
| | | | | |
| **Market Approach** | | | | |
| *Direct Market Data Method - Weighted Value* | 12,169,600 | | | |
| (No Discounts or Premiums) | - | 0% | | |
| Adjusted Value | 12,169,600 | | 40% | 4,867,840 |
| | | | | |
| **Income Approach** | | | | |
| *Capitalization Method - Control Adjusted* | 11,051,000 | | | |
| Less: Illiquidity Discount | (339,530) | 3.1% | | |
| Adjusted Value | 10,711,470 | | 60% | 6,426,882 |
| | | | | |
| Value - 100% Interest in Company | | | 100% | 11,294,722 |
| Times Interest to be Valued | | | | x 100% |
| Value Conclusion - 100% Interest in Company | | | | 11,294,722 |
| | | | | |
| **Value Conclusion - 100% Interest in Company (Rounded)** | | | | **$ 11,290,000** |

*It should be noted that valuation conclusions for closely held companies are generally rounded numbers. In this report, all values have been rounded to the nearest thousand and the final value is rounded to the nearest ten thousand. This is done in order to avoid giving the impression that these values are precise numbers.*

[113] Uniform Standards of Professional Appraisal Practice. The Appraisal Foundation, Washington, D. C., 2012-2013 Edition, Standards Rules 9-5.

### Final Reconciliation Weighting Explanation

**Asset Approach** (Section 5.4 *Application of Asset Approach*)
The Adjusted Book Value gives a floor value of the tangible assets. As the subject business is not asset intensive, and much of the value of the business comes from intangibles, this method has not been given any weight.

**Market Approach** (Section 5.5.7 *Reconciliation of Values Derived from the Market Approach*)
The Guideline Merger and Acquisition Methods utilized in this report used past transactions of private companies to determine an indicated value. Data from the DealStats Database and BIZCOMPS Database were analyzed. Based on the number and validity of comparable transactions and other factors discussed in Section 5.5.7, the Appraiser assigns 40% weight to this method.

**Income Approach** (Section 5.7 *Application of Income Approach*)
Potential business buyers often give much credence to the actual and expected earnings of a business. *Revenue Ruling 59-60* states that the value of a business should be based on its expected future earnings.

The Income Capitalization Method uses Net Cash Flow to Invested Capital as an income stream, which does not include owner's compensation. However, this approach develops a risk rate that takes into consideration certain factors like competition, industry risk, economic risk, profitability, depth of management and diversity, and the future business outlook; the market method does not have this level of detail. Additionally, it is the only method that factors in the annual working capital outlay. Furthermore, because at least one of the databases in the market approach had less than 20 comparable transactions, the appraiser felt that some of the weight should rely upon the income approach which is based on calculated risk and discount rates. Lastly, the sales and earnings of the Company are high enough to support absentee ownership, so the income stream used in this approach is applicable. Therefore, the Appraiser assigns 60% weight to this method.

## 5.10 Value Conclusion

In the opinion of the Appraiser, using accepted methods of valuation, and subject to the assumptions and limiting conditions incorporated herein, the Fair Market Value of the Stock (equity) Interest of **Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc.** as of September 30, 2019 is best expressed as (rounded):

| **100% Controlling Interest** |
|---|
| **Eleven Million Two Hundred Ninety Thousand Dollars**<br>**$11,290,000** |

The value above includes approximately $15,823,000 in identifiable current and fixed assets and $5,526,000 in liabilities (net $10,297,000) as per the Adjusted Book Value Method (Section 5.4 *Application of Asset Approach*). "The value of the intangible assets is determined by...the value of the business as identified in the business appraisal minus the sum of the working capital assets and the fixed assets being purchased"[114]; therefore the value of intangible assets is approximately $993,000.

[114] U.S. Small Business Administration Standard Operating Procedure (SOP) 50 10 5(K), p. 141

## 5.11 Review of Final Estimate Value for Reasonableness

There are several general rules of thumb that can be used as 'sanity checks' to verify that the appraised value is reasonable. There is one major point that needs to be mentioned. Rules of thumb give indications of value of the assets that normally transfer in a sale; in other words, cash, accounts receivable, and other liquid assets are typically not included and all debts must be paid off.

**Reconciliation - Stock Sale vs. Asset Sale**

| | | |
|---|---|---|
| Indicated Final Value of Company | $ | 11,290,000 |
| Less: Cash | | (214,290) |
| Less: Accounts Receivable | | (10,999,968) |
| Less: Inventory | | (167,553) |
| Less: Current and Other Assets | | (2,816,235) |
| Add: All Liabilities | | 5,525,833 |
| Indication of Typical Asset Value - Rounded | $ | 2,620,000 |
| Add: Inventory | | 167,553 |
| *Asset Value Including Inventory - Rounded* | $ | 2,788,000 |

Below are frequently used Rules of Thumb for (SIC or NAICS Code) 1799 – Construction - Specialty Trades[115] (sanity check) by business brokers, buyers and sellers:

**2 to 2.5 Times SDE Plus Inventory**

| | | | |
|---|---|---|---|
| Next Year's Seller's Discretionary Earnings | | $ | 1,054,585 |
| Times 2 | x | | 2.0 |
| 2 Times Seller's Discretionary Earnings | | **$** | **2,109,169** |
| Add: Inventory | | | 167,553 |
| Final Rule of Thumb Value | | $ | 2,276,722 |
| | | | |
| Next Year's Seller's Discretionary Earnings | | $ | 1,054,585 |
| Times 2.5 | x | | 2.5 |
| 2.5 Times Seller's Discretionary Earnings | | $ | 2,636,461 |
| Add: Inventory | | | 167,553 |
| Final Rule of Thumb Value | | **$** | **2,804,014** |

**Note: Above Income and Sales projections are from Section 4.9 *Financial Forecast***

It should be noted that rules of thumb do not consider the specific characteristics of a company as compared to the industry or other similar companies. Additionally, rules of thumb do not generally reflect changes in in the economy or subject industry over time. That being said, rules of thumb can be useful in testing the Appraiser's value conclusion to see if his/her multiples were within the typical range.

**In this case, the Company's value is within the range of values indicated by the earnings rules of thumb. The final asset value (*excluding inventory*) indicates a Price / SDE multiple of 2.48, which is reasonable based on the factors analyzed in this report. The purchase justification test on the next page will further test for reasonableness based on a hypothetical buyer's ROI and the proposed Debt Service Coverage Ratio (DSCR).**

[115] Tom West, *The Business Reference Guide* Online Edition, Published by Business Brokerage Press.

Another sanity check is the **Purchase Justification Test.** To test the final conclusion of value, the Appraiser adds working capital estimates and assumes a 20% down payment (based on the purchase price). Although this may differ from the Client's actual loan amount or use of proceeds, this method of justification assures that a hypothetical buyer purchasing the business as the appraised value, using market financing terms, is able to make a reasonable return on his or her investment.

The interest rate is estimated at Prime + 2.75% (currently 7.75% - assumed to remain constant for projected years) with a 10 year term. The Appraiser assumes a buyer will elect an S Corporation or LLC that will not be required to pay corporate taxes. Accordingly, tax rates are calculated by applying personal tax rates, using 2019 'Married Individuals Filing Joint Tax Returns' tax rates.[116] EBIT, EBITDA and growth rates are consistent with those used in the forecast from Section 4.9 *Financial Forecast.*

**PURCHASE JUSTIFICATION TEST**

| | | |
|---|---|---|
| Final *Asset* Value | $ 2,620,000 | |
| Add: Working Capital/Inventory | 430,000 | |
| Add: Closing Costs | 130,000 | |
| Total Project Cost | $ 3,180,000 | |
| Cash Down Payment by Buyer | 636,000 | 20% |
| Amount Financed by Lender | 2,544,000 | 80% |
| Seller Financing | 0 | 0% |

| **Projected Years:** | **FYE 2021** | **FYE 2022** | **FYE 2023** |
|---|---|---|---|
| Earnings before Interest and Taxes (EBIT) | $ 731,767 | $ 750,061 | $ 768,813 |
| Less: Lender Interest Payments | (191,018) | (176,935) | (161,721) |
| Less: Seller Note Interest | 0 | 0 | 0 |
| Projected Post Sales EBT | 540,749 | 573,126 | 607,091 |
| Income Taxes (married filing jointly) | (139,649) | (150,981) | (162,869) |
| Projected Net Income | 401,100 | 422,145 | 444,222 |
| Add: Depreciation and Amortization | 183,533 | 183,533 | 183,533 |
| Less: Lender Principal Payments | (175,350) | (189,433) | (204,647) |
| Less: Seller Principal Payments | 0 | 0 | 0 |
| Hypothetical Post Sale Cash Flow to Buyer | $ 409,282 | $ 416,244 | $ 423,108 |
| Return on Down Payment (Investment) | 64% | 65% | 67% |
| *Projected Cash flow plus Owners Salary* | *535,532* | *543,757* | *551,896* |
| Projected EBITDA | 915,265 | 938,147 | 961,601 |
| Total P&I (Bank and Seller Financing) | 366,368 | 366,368 | 366,368 |
| Debt Service Coverage Ratio | 2.50 | 2.56 | 2.62 |

As seen from the return on investment and Debt Service Coverage Ratio (DSCR), the buyer will make a reasonable return on his investment and cover the debt by over 2.50x in the initial year.

[116] Tax Foundation - https://taxfoundation.org/2019-tax-brackets/

# 6. PROFESSIONAL QUALIFICATIONS OF APPRAISER

## Neal Patel, CBA, CVA

Mr. Patel is the Principal and Founder of Reliant Business Valuation, a nationwide valuation firm that specializes in third-party certified **business valuations and equipment appraisals** for SBA lenders. He has extensive experience with small business valuations and financing, and firsthand ownership experience of multiple small businesses. This comprehensive experience helps him understand the intricacies of the businesses he appraises, while enabling him to add unique value to a nationwide roster of clients.

### EDUCATION

- Institute of Business Appraisers (IBA) – *Plantation, FL*
- National Association of Certified Valuators and Analysts (NACVA) – *Salt Lake City, UT*
- Rutgers University – *New Brunswick, NJ*
  Mini-MBA© - Essentials of Business
  Bachelor of Science - Computer Science

### MEMBERSHIPS/DESIGNATIONS

- Institute of Business Appraisers (IBA) – Certified Business Appraiser (CBA)
- National Association of Certified Valuators and Analysts (NACVA) – Certified Valuation Analyst (CVA)
- NACVA – Accredited in Business Appraisal Review (Candidate)
- American Society of Appraisers (ASA) – Accredited Senior Appraiser (Candidate)
- National Association of Government Guaranteed Lenders (NAGGL) – Associate Member

### ADVISORY BOARDS / COMMITTEES

**Institute of Business Appraisers**
Board of Governors, Former Chair (2014-2017)
Market Data Committee, Former Chair (2011-2013)
Business Broker Board (2010-2011)

**New Jersey City University**
Graduate Advisory Board (Accounting), Former Board Member

**National Association of Government Guaranteed Lenders**
Associate Members Committee

### VALUATION EDUCATION (PARTIAL)

- Accredited in Business Appraisal Review (ABAR) Course
- National Uniform Standards of Professional Appraisal Practice (USPAP) Course & Exam (Passed)
- Valuing Complex Family Limited Partnerships and LLCs
- Common Sense and the S Corp Value Question
- Regression Analysis –Construction and Interpretation
- The Business Appraiser as a Client Advocate
- Valuing Things You Cannot See
- The Sanity Check – Hypothetical Willing Buyer and Seller Test

- Working Your Way through the DLOM Minefield
- Impact of Leases Standard on Business Valuation Metrics
- Stock Market Analysis and Risk Premium Estimation – NACVA/ IBA
- Change the Way You Look at Your Business - NACVA/IBA
- The Sale of a Business: Strategies and Techniques used by Business Intermediaries – NACVA/IBA
- Ethics and Standards Workshop – NACVA/IBA
- Influence, Impact and Income – Your Recipe to Thrive in Today's Economy – NACVA/IBA
- Subsequent Events – NACVA/IBA
- Quantifying Company Specific Risk Using the Frinson/Daily Model – NACVA/IBA
- New Formulas for Terminal Value That Overcome the WACC Problem – NACVA/IBA
- Marketability Discounts: We Can Now Reconcile Differing Approaches and Methods – NACVA/IBA
- Governance, Ethics and Accountability – NACVA/IBA
- Mock Deposition for a Business Valuation Engagement – NACVA/IBA
- Case Law Update – NACVA/IBA
- Tricks and Traps in the Valuation of Medical Practices, Local Markets and Cap Rates – NACVA/IBA
- Adjusting Multiples from Public Guidelines for Private Firms – NACVA/IBA
- Standards of Value: When Should Fair Value Replace Fair Market Value? – NACVA/IBA
- Trends in Valuation: An Experts Panel Discussion – NACVA/IBA
- The CBA, ABAR and AIBA Peer Review Process – NACVA/IBA
- Reviewing Valuation Reports: Credibility, Reliability and Relevance – NACVA/IBA
- Will the Real Cost of Capital Please Stand Up? – NACVA/IBA
- Regression Analysis as a Tool for Validating Methodology – NACVA/IBA
- Other Valuation Adjustments – What Should We Do With Them – NACVA/IBA
- The Income Approach: It's Not all About the Cost of Capital – NACVA/IBA
- Transactional Databases – Useful or Useless – NACVA/IBA
- Appraisers in a Choke Hold: Regulatory and Ethical Issues for Valuation – NACVA/IBA
- Introduction to Business Appraisal Review – NACVA/IBA
- Meaningful Financial Analysis and Supporting Normalization Adjustments – NACVA/IBA
- Dealing with Interest Bearing Debt in Valuations – NACVA/IBA
- Improving the Valuation of Small Companies Using Public Company Data – NACVA/IBA
- The Market Approach in Times of Trouble – NACVA/IBA
- Report Writing, and Analysis (1010) - IBA
- Preparing for the CBA Exam (1006B) – IBA
- Essentials of Business Appraisal (8002B) – IBA
- Essentials of Business Appraisal (8002A) – IBA

## RECENT SBA ARTICLES & VALUATION INSTRUCTION

- SBA Value™ (August 2010) – *The Market Approach Done Correctly*
- Coleman Publishing (September 2010) – *SOP 50 5 10 (C) Changes that Affect Business Valuations*
- Scotsman Guide Commercial Magazine (November 2010) – *The Value of Valuation Rules*

- SBA Value™ (January 2011) – *Essential Elements to Look For When Reviewing a Valuation*
- SBA Value™ (April 2011) – *Risky Business: Relying on Valuation Rules of Thumb*
- Coleman Publishing (September 2011) – Instructor for *Underwriting Risk / Valuation* Webinar
- SBA Value™ (December 2011) – *Unlock the Answers – Business Valuation FAQ*
- Georgia Lender's Quality Circle (February 2012) – Instructor for Business Valuations Training Seminar
- SBA Value™ (March 2012) – *Utilizing Equipment Appraisals in Business Valuations*
- SBA America East Conference (August 2012) – Instructor for Business Valuations Training Seminar
- NAGGL Conference (October 2012) – Instructor for Business Valuations Training Seminar
- SBA Region IV (NCBA) Conference (November 2012) – Instructor for Business Valuations Training
- SBA San Antonio District Office (December 2012) – Instructor for Business Valuations Training
- Southeastern Lenders Conference (February 2013) – Instructor for Business Valuations Training Seminar
- Mid America Lender's Conference (August 2013) – Instructor for Business Valuations Training Seminar
- Southeastern Lender's Conference (February 2014) – Instructor for Business Valuations Training Seminar
- W.P.A.S.G.L. Conference (March 2014) – Instructor for Business Valuations Training Seminar
- SBA Region III & IV (April/May 2014) - Instructor for Business Valuations Training Webinars
- Mid America Lender's Conference (August 2014) – Instructor for Business Valuations Training Seminar
- FLAGGL Conference (September 2014) – Instructor for Business Valuations Training Seminar
- Southeastern Lenders Conference (GA) (February 2015) – Instructor for Business Valuations Training
- Overdrive Lenders Conference (TX) (March 2015) – Business Valuations Training Seminar
- SBA Great Lakes Lenders Conference (MI) (July 2015) – Business Valuations Training Seminar
- Mid America Lender's Conference (August 2015) – Instructor for Business Valuations Training Seminar
- America East Conference (MD) (August 2015) – Instructor for Business Valuations Training Seminar
- NAGGL Conference (NV) (October 2015)- Instructor for Business Valuations Training Seminar
- KY SBA Lenders Conference (November 2015) – Instructor for Business Valuations Training Seminar
- Southeastern Lenders Conference (SC) (February 2016) – Instructor for Business Valuations Training
- SBA Value™ (May 2016) – *Clarification of 25% Contribution in a Partner Buyout*
- SBA Great Lakes Lenders Conference (MI) (July 2016) – Business Valuations Training Seminar
- America East Conference (PA) (August 2016) – Instructor for Business Valuations Training Seminar
- FLAGGL Conference (FL) (September 2016) – Instructor for Business Valuations Training Seminar
- SBA Region III (November 2016) - Instructor for Business Valuations Training Webinar
- SBA Value™ (November 2016) - *The Pitfalls of Price to Revenue Multiples*
- SBA Value™ (January 2017) - *Appraisals of Special Purpose Properties*
- SBA Kentucky District (February 2017) - Instructor for Business Valuations Training Webinar
- SBA New Mexico District (February 2017) - Instructor for Business Valuations Training Webinar
- Southeastern Lenders Conference (SC) (February 2017) – Instructor for Business Valuations Training
- SBA Value™ (May 2017) - *Calculating Cash Flow (appraiser vs. lender)*
- SBA Value™ (June 2017) - *How to Determine a Reasonable Earnings Multiple*
- SBA Great Lakes Lenders Conference (MI) (July 2017) – Advanced Business Valuations Training Seminar
- America East Conference (MA) (July 2017) – Advanced Change of Ownership Training Seminar
- SBA Region III (August 2017) - Instructor for Determining the Value of Business Training Webinar

- SBA New Mexico District (October 2017) - Instructor for Business Valuations Basics Training Webinar
- SBA Value™ (October 2017) - Updates in the SOP 50 10 5(J) That Impact Business and Equipment Appraisals
- SBA Colorado District (December 2017) - Instructor for Business Valuations Basics Training Webinar
- SBA Region III (December 2017) - Instructor for Updates in the SOP 50 10 5(J) Impacting Valuations
- Southeastern Lenders Conference (NC) (March 2018) – Instructor for Business Valuations Training
- W.P.A.S.G.L. Conference (March 2018) – Instructor for Business Valuations Training Seminar
- SBA Region III (March 2018) – Introduction to Business Valuations Webinar

# Matthew Lore, CVA

**Mr. Lore is a Business Appraiser working at Reliant Business Valuation, a nationwide valuation firm that specializes in third-party certified business valuations and equipment appraisals for SBA lenders.** He has extensive experience with all aspects of the business valuation process including industry research, financial statement analysis, application of the valuation approaches, and report composition. Mr. Lore has appraised businesses in various industries, including professional services, retail, construction, and manufacturing, among others.

## EDUCATION

- National Association of Certified Valuators and Analysts (NACVA) – *Salt Lake City, UT*
- The College of New Jersey – *Ewing, NJ*

  Bachelor of Science – Economics

## MEMBERSHIPS/DESIGNATIONS

- National Association of Certified Valuators and Analysts (NACVA) – Certified Valuation Analyst (CVA)

## VALUATION EDUCATION (PARTIAL)

- Certified Valuation Analyst (NACVA) – Self-Study Program & Exam (Passed)
  - BV: Fundamentals, Techniques, & Theory
  - BV: Applications and Calculations of the Income and Asset Approaches
  - BV: Case Analysis – Completed Transaction and Guideline Public Comparable Methods
  - Special Purpose Valuations – Fair Value for Financial Reporting, Mergers and Acquisitions, and Litigation
- Discount for Lack of Marketability
- What the IRS Looks for When Evaluating a Business Valuation Report
- One Twist is All it Takes – Preventing Fraud and Mismanagement in Government
- Valuation of Cash-Intensive Businesses for Divorce Purposes and Related Forensic Analysis
- Intangible Assets: Identification and Common Valuation Approaches
- Best Practices: Business Valuation Methods
  - Cost of Capital
  - Capitalized Cash Flow
  - Discounted Cash Flow
  - Guideline Public Company Method
  - Guideline Company Transactions Method
  - Report Writing
- A Closer Look at the Data We Use: Calculations and USPAP
- The Impact of the New Tax Law on Business Valuation
- Confessions of Two Reluctant Expert Witnesses
- Hitchner & Gregory – Supporting Your Business Valuation with the IRS
- Valuation's Dirty Little Secrets

## RECENT SBA ARTICLES & VALUATION INSTRUCTION

- SBA Value™ (November 2016) – *The Pitfalls of Price to Revenue Multiples*

# 7. COMPANY PROFILE

Reliant Business Valuation, LLC is a full service nationwide valuation firm that specializes in Certified Business Valuations and Certified Machinery and Equipment Appraisals for conventional and SBA guaranteed financing purposes. All reports comply with the latest SBA Standard Operating Procedure 50 10 5 and USPAP guidelines. All business valuations are compiled by a Certified Business Appraiser (CBA) or Certified Valuation Analyst (CVA), and all equipment appraisals are compiled by a Certified Machinery and Equipment Appraiser (CMEA).

Our firm and its appraisers belong to the most respected associations in the country, including the Institute of Business Appraisers (IBA), the National Association of Certified Valuators (NACVA), the American Society of Appraisers (ASA) and the National Equipment & Business Builders (NEBB) Institute.

We perform business valuations for the most popular SBA guaranteed industries and franchises. This experience, along with the strict educational requirements of the IBA, the NACVA and the NEBB Institute, makes our appraisers experts in their field.

Our clients include over 150 national, regional and community banks (and non-bank lenders), across the United States of America. References and testimonials are available upon request.

# 8. ADDITIONAL DOCUMENTS

All documents relied upon in this valuation were either provided by the Client, or supplied by the buyer/seller/seller's representative and subsequently forwarded to the Client for their records. The following documents may not have been delivered to the Client, so they are included in this section.

| Document Type / Title | Reference in the following section: |
|---|---|
| Supplemental Questionnaire | Multiple Sections |

# Supplemental Questions

Blue Diamond Sheet Metal

reliant
BUSINESS VALUATION
1246 South River Road, Suite 101, Cranbury, NJ 08512
T: 908.888.6030 F: 908.888.6040

| Please provide the contact information of the person filling out this questionnaire (required): | |
|---|---|
| Full Name | **Albert LaBella and Meghan LaBella** |
| Title / Company | **Blue Diamond Sheet Metal** |
| Phone Number | **516 790 3042** |
| Email Address | **alabella@bdsheetmetal.com** |

*Please note that we may have additional questions or require further documentation after receiving the answers below. In order to meet bank-mandated deadlines, please promptly respond to all requests and feel free to contact us at any time with questions you may have.*

**In this questionnaire, "Company" refers to the combined operations of Blue Diamond Sheet Metal, Inc., Diam-N-Blu Mechanical Corp., and Mirage Mechanical Systems, Inc., unless otherwise specified.**

**History**

1. Are there any subsidiary companies owned by the subject Company?
   No

2. Are there any restrictions of transfer or litigation currently pending that would adversely affect the value of the subject Company?
   No

**Management**

1. Please identify each owner(s) role in the Company below:

| Owner | # Hours worked/week | Daily or Weekly Responsibilities |
|---|---|---|
| Rob Belz | 40 | Controller |
| Stephen Dimeglio | 20 | PM BDSM |
| James Dvorak | 20 | PM DnB |
| Al LaBella | 40 | Sales Operations |

**Equipment**

1. Based on the Company's current operations, would the current owner or hypothetical buyer be required to purchase any new equipment or make any additional capital expenditures within the next 3 years?
   Yes

   a. If so, please describe type and cost. A new drafting program, we have identified one that will cost $100,000, which will make us more efficient

2. How much does the Company spend on equipment and other capital expenditures in a typical year?
   $150,000 to $200,000

**Products and Services**

1. How many customers does the Company serve in a typical year?
   Changes yearly

# Supplemental Questions

## Blue Diamond Sheet Metal

2. Do any customers contribute 15% or more to the Company's business in a typical year? If so, please answer the following questions about each customer that contributes 15% or more to annual sales:

   a. Name of customer and approximate percentage of sales contributed:
   Tomco Mechnaical 17% Sound Air Conditioning 17.5%

   b. How long has the Company been doing business with this customer?
   Tomco 8 years Sound 6 years

   c. Does the Company have any contracts which guarantee exclusivity or revenue with this customer?
   No

   d. Why does this customer choose the Company over competitors?
   Reputation, performance, accountability, professionalism

3. Is the Company's business seasonal (e.g., higher sales during winter months)? If so, please describe seasonality and its effect on sales.
   No

**Financial**

1. Sales for the three combined entities have increased from $28.8MM in FYE 2017 to $34.2MM in FYE 2019. Please explain the reason for this increase.
   Increase is based on the number of bids won.

2. The interim sales through 9/30/2019 were $$16,612,324 as per the reviewed income statements. Annualizing the figure projects total sales to be approximately $33.2MM for the fiscal year ending 3/31/2020.

   a. Does the Company feel the annualized sales are accurate?
   Yes

   b. If the Company projects sales differently from the annualized sales above, please state the Company's projected sales for the fiscal year ending 3/31/2020. Please also describe why the Company feels these projections are accurate.
   Between 30 and 33 million is accurate based on our projections, and current bidding.

3. The Company's accounts receivable balance as of 9/30/2019 was $9,793,477 (excluding retainages).

   a. Please forward an A/R Aging Report as of 9/30/2019.
   See attached

   b. Please also comment on the collectability (95%, 90%, etc.) of both the balance less than 90 days and over 90 days past due:

| A/R Age | Collectability % |
|---|---|
| Less than 90 days | 95% |
| Over 90 days | 90% |

4. Please confirm that all assets and liabilities will remain with the Company after the buyout.
   Yes

BLUE DIAMOND SHEET METAL INC

AGED ACCOUNTS RECEIVABLE

SEPTEMBER 30, 2019

| | CONTRACTS | 0-30 DAYS | 31-60 DAYS | 61-90 DAYS | OVER 90 DAYS | OVER 120 DAYS | RETAINAGE | SUBSEQUENT COLLECTIONS |
|---|---|---|---|---|---|---|---|---|
| AKS International | $ 1,058,191 | $ 437,920 | $ 475,457 | $ 169,020 | $ 16,760 | $ (40,966) | $ 261,684 | $ 1,094,079 |
| Anron Air Systems | 259,864 | | | | | 259,864 | | |
| Astro Air Corporation | 212,571 | | | | | 212,571 | 6,125 | |
| BP Air Conditioning Corp. | 86,864 | | | | | 86,864 | | 21,454 |
| BP Mechanical Corp. | 40,245 | | | | | 40,245 | | 4,555 |
| C.D.E. Air Conditioning Co. | 307,076 | 110,260 | 99,268 | | | 97,548 | 166,841 | 182,000 |
| Chapman and Evans Inc. | 73,219 | | | | 8,683 | 64,536 | | 30,043 |
| Clover Mechanical Inc. | 123,705 | 81,855 | 41,850 | | | | 13,745 | 123,705 |
| Clune Construction Company | 21,391 | | | | 1,775 | 19,616 | | 21,391 |
| Dierks Heating Company | 543,218 | 304,826 | 180,446 | | 6,492 | 51,454 | 108,682 | 489,277 |
| Donnelly Mechanical Corp. | 845,301 | 574,571 | 229,005 | | | 41,725 | 76,440 | 505,416 |
| Framan Mechanical Inc. | 51,829 | | | | | 51,829 | | |
| F.W. Sims Inc. | 260,870 | 63,166 | 53,248 | 25,963 | | 118,493 | 172,828 | 89,491 |
| GDO Contracting Corp. | 1,334,669 | | 24,458 | | | 1,310,231 | | 250,000 |
| Independent Temperature Control | 13,605 | | | | | 13,605 | 19,730 | |
| Intercounty Mechanical | 49,368 | 25,118 | | | 24,250 | | 8,691 | 24,250 |
| JPR Mechanical Inc. | 225,670 | | | | | 226,670 | | |
| Major Systems Mechanical | 29,591 | | | | | 29,591 | | 29,591 |
| Master Mechanical | 14,939 | | | | | 14,939 | | 11,000 |
| Midtown A/C and Vent. | 49,575 | | | | | 49,575 | | |
| Northshore Climate Control | 212,775 | 127,594 | 76,124 | | | 8,957 | 240,519 | 141,759 |
| Carried forward | 5,815,556 | 1,725,410 | 1,179,856 | 194,983 | 57,960 | 2,657,347 | 1,075,285 | 3,018,011 |

BLUE DIAMOND SHEET METAL INC

AGED ACCOUNTS RECEIVABLE

SEPTEMBER 30, 2019

| | CONTRACTS | 0-30 DAYS | 31-60 DAYS | 61-90 DAYS | OVER 90 DAYS | OVER 120 DAYS | RETAINAGE | SUBSEQUENT COLLECTIONS |
|---|---|---|---|---|---|---|---|---|
| Brought forward | $ 5,815,556 | $ 1,725,410 | $ 1,179,856 | $ 194,983 | $ 57,960 | $ 2,657,347 | $ 1,075,285 | $ 3,018,011 |
| Quinn and Feiner Services Corp | 23,229 | 6,472 | (2,356) | | 135 | 18,988 | 3,247 | |
| Pierpont Mechanical Corp | 890,812 | 288,090 | 349,118 | 120,430 | 25,531 | 107,643 | 152,747 | 630,660 |
| RJR Mechanical Inc. | 48,627 | | | | | 48,627 | | |
| Skanska Walsh Design Build | 45,000 | | 45,000 | | | | 5,000 | 45,000 |
| Sound Refrigeration and Air Conditioning | 632,114 | 237,215 | 202,760 | 31,794 | | 160,345 | 498,684 | 631,113 |
| Tomco Mechanical Corp. | 538,094 | 210,466 | 323,733 | 3,895 | | | 50,335 | 405,266 |
| Trane US, Inc. | 469,536 | 84,786 | 234,450 | 150,300 | | | 52,702 | 420,522 |
| WDF Inc. | 109,398 | | | | | 109,398 | | |
| Miscellaneous (under $10,000) | 27,018 | 9,899 | 2,423 | | | 14,696 | 1,860 | 45,656 |
| | $ 8,599,384 | $ 2,562,338 | $ 2,334,974 | $ 501,402 | $ 83,626 | $ 3,117,044 | $ 1,839,860 | $ 5,196,228 |

DIAM-N-BLU MECHANICAL CORP.

AGED ACCOUNTS RECEIVABLE

SEPTEMBER 30, 2019

| | Contracts | 0-30 Days | 31-60 Days | 61-90 Days | Over 90 Days | Retainages | 12/20/2019 Subsequent Collections |
|---|---|---|---|---|---|---|---|
| Axis Construction Corp. | $ 213,703 | | $ 91,591 | | $ 122,112 | | $ 108,800 |
| Astro Air Corporation | 36,725 | $ 32,150 | 455 | $ 3,722 | 398 | $ 600 | 32,150 |
| Aurora Contractors | 49,321 | 10,427 | | | 38,894 | | 852 |
| Blackhawk Systems Inc. | 20,715 | | | | 20,715 | | |
| Carrier Enterprise Northeast | 16,860 | | | | 16,860 | | |
| Concern For Independent Living | 23,288 | 13,747 | 6,744 | 120 | 2,677 | | 16,321 |
| Dot Federal Aviation | 22,300 | | | | 22,300 | | 22,300 |
| Good Samaritan Hospital | 37,490 | 37,490 | | | | | 37,490 |
| Johnson Controls | 12,237 | | | | 12,237 | | 450 |
| Keegans-3584 Construction | 113,000 | | | | 113,000 | | 113,000 |
| Mccloskey Mechanical Cont. | 21,954 | | | 11,000 | 10,954 | | 11,000 |
| North Shore LIJ Health Systems | 26,571 | 1,413 | 1,210 | 2,558 | 21,390 | | 7,787 |
| Riverhead CSD | 87,933 | 47,883 | 38,191 | | 1,859 | | 85,074 |
| Schulman Lobel | 19,544 | | | 6,975 | 12,569 | | 8,002 |
| Sid Jacobsen J.C.C. | 11,743 | 3,738 | 2,539 | | 5,466 | | 6,277 |
| Town of Brookhaven | 36,813 | | | 36,813 | | 76,001 | |
| Tri-Rail Construction Inc. | 33,000 | | | | 33,000 | | |
| Valco Inc. | 327,239 | 211,431 | 115,808 | | | 42,804 | 171,000 |
| Miscellaneous (under $10,000) | 83,655 | 25,505 | 9,256 | 3,810 | 45,084 | 19,866 | 32,102 |
| | $ 1,194,091 | $ 383,784 | $ 265,794 | $ 64,998 | $ 479,515 | $ 139,271 | $ 653,605 |